



DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[TD 9969]

RIN 1545-BP01

Treatment of Special Enforcement Matters

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that except certain partnership-related items from the centralized partnership audit regime created by the Bipartisan Budget Act of 2015, and sets forth alternative rules that will apply to the examination of excepted items by the IRS. The centralized partnership audit regime does not apply to a partnership-related item if the item involves a special enforcement matter described in these regulations. Additionally, these regulations make changes to the existing centralized partnership audit regime regulations to account for changes to the Internal Revenue Code (Code) as well as changes that clarify those regulations. The regulations affect partnerships and partners to whom special enforcement matters apply.

DATES: Effective date: These regulations are effective on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Applicability date: For dates of applicability, see §§301.6221(b)-1(f); 301.6225-1(i)(1); 301.6225-2(g)(1); 301.6225-3(e)(1); 301.6226-2(h)(1); 301.6241-3(g); 301.6241-7(j)

FOR FURTHER INFORMATION CONTACT: Jennifer M. Black of the Office of Associate Chief Counsel (Procedure and Administration), (202) 317-6834 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final amendments to the Procedure and Administration Regulations (26 CFR part 301) regarding special enforcement matters under section 6241(11) of the Code and the collection of amounts due under the centralized partnership audit regime pursuant to section 6241(7) of the Code. Section 6241(11) was enacted by section 206 of the Tax Technical Corrections Act of 2018, contained in Title II of Division U of the Consolidated Appropriations Act of 2018, Public Law 115-141 (TTCA). This document also contains several amendments to the final regulations on the centralized partnership audit regime published in TD 9844 (84 FR 6468) on February 27, 2019.

Section 1101(a) of the Bipartisan Budget Act of 2015, Public Law 114-74 (BBA) amended chapter 63 of the Code (chapter 63) by removing former subchapter C of chapter 63 effective for partnership taxable years beginning after December 31, 2017. Former subchapter C of chapter 63 contained the unified partnership audit and litigation rules enacted by the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97-248 (TEFRA) that were commonly referred to as the TEFRA partnership procedures, or simply TEFRA. Section 1101(b) of the BBA removed subchapter D of chapter 63 and amended chapter 1 of the Code (chapter 1) by removing part IV of subchapter K of chapter 1, rules applicable to electing large partnerships, effective for partnership taxable years beginning after December 31, 2017. Section 1101(c) of the BBA replaced the TEFRA partnership procedures and the rules applicable to electing large partnerships with a centralized partnership audit regime that determines adjustments and, in general, determines, assesses, and collects tax at the partnership level. Section 1101(g) of the BBA set forth the effective dates for these statutory amendments, which are effective generally for returns filed for partnership taxable years beginning after

December 31, 2017. On December 18, 2015, section 1101 of the BBA was amended by the Protecting Americans from Tax Hikes Act of 2015, Public Law 114-113 (PATH Act). The amendments under the PATH Act are effective as if included in section 1101 of the BBA, and therefore, subject to the effective dates in section 1101(g) of the BBA.

Enacted on March 23, 2018, the TTCA made a number of technical corrections to the centralized partnership audit regime, including adding sections 6241(11) (regarding the treatment of special enforcement matters) and 6232(f) (regarding the collection of the imputed underpayment and other amounts due from partners of the partnership in the event the amounts are not paid by the partnership) to the Code. The amendments to subchapter C of chapter 63 included in the TTCA are effective as if included in section 1101 of the BBA, and therefore, subject to the effective dates in section 1101(g) of the BBA.

On January 2, 2018, the Department of the Treasury (Treasury Department) and the IRS published in the **Federal Register** (82 FR 28398) final regulations under section 6221(b) providing rules for electing out of the centralized partnership audit regime (TD 9829).

On August 9, 2018, the Treasury Department and the IRS published in the **Federal Register** (83 FR 39331) final regulations under section 6223 providing rules relating to partnership representatives and final regulations under §301.9100-22 providing rules for electing into the centralized partnership audit regime for taxable years beginning on or after November 2, 2015, and before January 1, 2018.

On February 27, 2019, the Treasury Department and the IRS published in the **Federal Register** (84 FR 6468) final regulations implementing sections 6221(a), 6222, and 6225 through 6241 of the centralized partnership audit regime (TD 9844).

On November 24, 2020, the Treasury Department and the IRS published in the **Federal Register** (85 FR 74940) a notice of proposed rulemaking (REG-123652-18)

(November 2020 NPRM) proposing rules to implement section 6241(11) dealing with special enforcement matters and to make changes to the regulations under the centralized partnership audit regime. The Treasury Department and the IRS received written public comments in response to the regulations proposed in the November 2020 NPRM, and a public hearing regarding the proposed regulations was held on March 25, 2021.

After careful consideration of all written public comments received in response to the November 2020 NPRM as well as statements made during the public hearing, the November 2020 NPRM is adopted with the revisions described in the preamble to this Treasury Decision in response to those comments and statements.

Summary of Comments and Explanation of Revisions

Three written comments were received in response to the November 2020 NPRM. Two statements were made at the public hearing held on March 25, 2021. All of these comments (both written and provided orally at the public hearings) have been considered, and revisions to the regulations were made in response to the comments. The written comments received are available for public inspection at www.regulations.gov or upon request.

In addition to changes in response to the comments, editorial revisions were made to correct typographical errors and grammatical mistakes. Revisions were also made to clarify language in the proposed regulations that was potentially unclear. Unless specifically described in this Summary of Comments and Explanation of Revisions, such revisions were not intended to change the meaning of the language that was revised. Finally, the Treasury Department and the IRS have decided not to finalize the proposed changes to §301.6241-3(d) and plan to withdraw the proposed changes.

1. Applicability Date

Two comments were received regarding the applicability date of clarifications that were made to the rules regarding elections out of the centralized partnership audit regime. Proposed §301.6221(b)-1(f) provided that all proposed adjustments to §301.6221(b)-1 would be applicable as of November 20, 2020, the date the November 2020 NPRM was filed for public inspection with the **Federal Register**. The November 2020 NPRM proposed the addition of qualified subchapter S subsidiaries (QSubs) as an additional example of partner to be added to the list of ineligible partners under §301.6221(b)-1(b)(3)(ii). One comment noted that while this additional example of ineligible partner was included in Notice 2019-06, 2019-03 IRB 353 (January 14, 2019) announcing forthcoming proposed regulations, Notice 2019-06 also included a rule for partnerships with QSub partners similar to the rule for partnerships with S corporation partners under section 6221(b)(2)(A), but the proposed rule in the November 2020 NPRM did not propose the rule previously described in Notice 2019-06. Both comments recommended that the applicability date for this additional example of ineligible partner should therefore not be November 20, 2020, but should be applicable for partnership tax years ending after the date the final rule is finalized and published in the **Federal Register** to allow partnerships with QSub partners time to restructure if desired.

These comments are not adopted. The November 2020 NPRM did propose rules that were not identical to the rules previously described in Notice 2019-06, which is one reason the November 2020 NPRM did not propose, pursuant to section 7805(b)(1)(C) of the Code, an applicability date of January 14, 2019, the day that Notice 2019-06 was issued. However, pursuant to section 7805(b)(1)(B) the November 2020 NPRM proposed an applicability date of November 20, 2020, the date that the November 2020 NPRM was filed with the **Federal Register**. The originally proposed applicability date of November 20, 2020, would have little or no effect on taxpayers,

whereas changing the proposed applicability date to the date that this Treasury decision is published in the **Federal Register** creates an administrative burden for the IRS. The only possible effect on taxpayers is that they may be subject to the centralized partnership audit procedures if they are selected for examination by the IRS and it may require them to file an administrative adjustment request (AAR) under section 6227 of the Code in lieu of an amended Form 1065. For the IRS, absent this rule being applicable on the proposed applicability date of November 20, 2020, there would be uncertainty regarding whether the centralized partnership audit regime applies to any partnership that has a QSub as a partner during the period beginning on November 20, 2020, and ending on the date of publication of this Treasury decision in the **Federal Register**. This uncertainty could cause significant delays that hinder the IRS's ability to examine these partnerships in a timely and efficient fashion. By retaining the earlier proposed applicability date of November 20, 2020, the final regulations provide certainty for both the IRS and taxpayers.

One comment was received regarding the applicability dates for the proposed regulations under §§301.6225-1, 301.6225-2, 301.6226-2, 301.6241-3, and 301.6241-7 in the November 2020 NPRM. The proposed regulations proposed that the majority of the proposed rules would be applicable on November 20, 2020, the date the November 2020 NPRM was filed with the **Federal Register**. In contrast, proposed §301.6241-7(b) would be applicable for partnership taxable years beginning on or after December 20, 2018, the date Notice 2019-06 was published. Although the comment noted that, under section 7805(b)(1), the final regulations could be applicable to partnership taxable years ending on or after November 20, 2020, or on or after December 20, 2018, for §301.6241-7(b), the comment recommended that all of the final regulations be applicable to partnership taxable years ending after the date the final rules are published in the **Federal Register**. The comment suggests that this delay would give

partnerships sufficient time after the rules are finalized to adjust their internal tax compliance and reporting procedures as well as review their existing partnership agreements to account for the final rules.

The comment recommended that the majority of the final regulations that were proposed in the November 2020 NPRM be applicable on the date the final regulations are published in the **Federal Register**, but the comment also recommended more specific changes to some of the applicability dates. Under proposed §301.6241-3(g), the changes to §301.6241-3 were proposed to be applicable to any determinations made on or after November 20, 2020. The comment stated that the rules under proposed §301.6241-3 could not, under section 7805(b)(1), be applicable for determinations on or after November 20, 2020, because then the rule would apply to taxable years ending prior to November 20, 2020, which the comment said was not consistent with section 7805(b)(1) as it provides that, except as otherwise provided, “no temporary, proposed, or final regulation relating to the internal revenue laws shall apply to any taxable period ending before the earliest of” certain dates, in this case the date on which the proposed regulations were filed with the **Federal Register**.

The final rules under §301.6241-7, except for §301.6241-7(b), were proposed to be applicable for taxable years beginning on or after November 20, 2020, but also to any examinations or investigations beginning after November 20, 2020. Similar to the comment regarding the applicability of proposed §301.6241-3, the comment recommended that the applicability date provision be removed as the comment noted that this would allow the final regulations to be applicable to taxable years ending before November 20, 2020, including taxable years beginning prior to the applicability date of the centralized partnership audit regime. The comment noted that although section 7805(b)(1)(C) permitted the final regulations to be applicable to taxable years ending no earlier than the date Notice 2019-06 was published, as it substantially described the

expected contents of the final regulations, the commenter felt as if this would not be within the “spirit” of section 7805(b) given that over two years have passed since Notice 2019-06 was published and could result in the provisions being applied to examinations already in progress.

As the comment acknowledged, section 7805(b) provides that “no temporary, proposed, or final regulation relating to the internal revenue laws shall apply to any taxable period ending before the earliest of the following dates”: the date on which the final regulations are filed with the **Federal Register**, the date on which the proposed regulations were filed with the **Federal Register**, or the date on which a notice substantially describing the expected contents of the final regulations was issued to the public. As with the amendments to the rules under §301.6221(b)-1, delaying the applicability date of proposed §§301.6225-1, 301.6225-2, 301.6226-2, 301.6241-3, and 301.6241-7 could hinder the IRS’s ability to conduct examinations in a timely and efficient manner and to utilize the assessment rules of section 6232(f) for partnerships that fail to pay imputed underpayments. It also could cause uncertainty for partnerships who may have chapter 1 liabilities, adjustments to non-income items that do not result in an imputed underpayment, or for partnerships that have arranged their affairs to be consistent with Notice 2019-06 and the proposed regulations.

Partnerships were notified of these proposed regulations on November 20, 2020, and on December 20, 2018, for the rules in proposed §301.6241-7(b). As the comment correctly noted, for the provisions in proposed §301.6241-7(b), partnerships have had well over two years to adjust their affairs in anticipation of the final regulations. For the other regulations, partnerships have had since November 20, 2020, to arrange their affairs to account for the final regulations. The Treasury Department and the IRS have determined that the administrative burden placed on the IRS in not being able to utilize final procedural rules (that is, rules not affecting the determination of underlying tax

liabilities) as soon as possible far outweighs giving partnerships additional time to implement changes to account for procedural rules the general substance of which they have been aware of since November 20, 2020. Therefore, the suggestion to make the regulations applicable as of the date the final regulations are published in the **Federal Register** is not adopted.

In addition, although the comment expressed concerns that the final regulations could apply to taxable years beginning before the applicability date of the centralized partnership audit regime, this concern is unfounded. The centralized partnership audit regime does not apply to taxable years beginning prior to January 1, 2018, for which an election under §301.9100-22 was not made. If the centralized partnership audit regime does not apply to a partnership for a particular taxable year, then these regulations, which clarify the application of the centralized partnership audit regime, are irrelevant to the examination of that particular partnership's taxable year.

As previously noted, the comment also expressed concern that the applicability of the regulations could apply to taxable years prior to the date the November 2020 NPRM was filed with the **Federal Register** as the regulations were proposed to be applicable to any examinations or investigations beginning after November 20, 2020, the date the November 2020 NPRM was filed with the **Federal Register**. This Treasury decision adopts this comment. Accordingly, the applicability dates have been modified to remove the provision that applied the regulations to examinations or investigations beginning after November 20, 2020, and to clarify that the final regulations apply to taxable years ending on or after November 20, 2020, or taxable years beginning after December 20, 2018, in the case of the final regulations in §301.6241-7(b).

In the November 2020 NPRM, the applicability date in proposed §301.6241-7(j)(1) provided that the IRS and a partner under examination could agree to apply any provision (except §301.6241-7(b)) to taxable years prior to the general applicability date.

The Treasury Department and the IRS have decided that partnerships should also have the flexibility to agree to apply §301.6241-7(g) (chapter 1 taxes and penalties that are the liability of the partnership) prior to the general applicability date as well. This may be especially beneficial for partnerships in situations where the IRS proposes to reduce a chapter 1 tax or penalty reported by the partnership. Accordingly, §301.6241-7(j)(1) is updated to provide that the IRS and the partnership may agree to apply §301.6241-7(g) for taxable years ending prior to November 20, 2020, provided that taxable year is otherwise subject to the centralized partnership audit regime.

2. Adjustments to Non-Income Items

A. Taking into account adjustments to non-income items that are adjustments that do not result in an imputed underpayment

Under section 6241(2)(B) and §301.6241-1(a)(6)(ii), the term “partnership-related item” includes items or amounts “relating to any transaction with, basis in, or liability of the partnership.” Accordingly, the definition of “partnership-related item” includes items that are not items of income, gain, loss, deduction, or credit (non-income items). As defined in §301.6225-1(d)(2)(iii) prior to the November 2020 NPRM, a positive adjustment is any adjustment that is not a negative adjustment as defined in §301.6225-1(d)(2)(ii). A negative adjustment is any adjustment that is a decrease in an item of income (or treated as a decrease in an item of income), or an increase to an item of credit. An adjustment to an item that is a non-income item is not a decrease in an item of income. Therefore, adjustments to a partnership’s non-income items are always positive adjustments, are never negative adjustments, and are not netted against any adjustments to a partnership’s items of income, gain, loss, deduction, or credit under section 702(a). Therefore, adjustments to a partnership’s non-income items are adjustments that do not result in an imputed underpayment in situations where a net negative adjustment to a credit, or an item treated as a credit, reduces the imputed

underpayment to zero or less than zero. Under proposed §301.6225-3(b)(8), if an adjustment to a non-income item is an adjustment that does not result in an imputed underpayment, the partnership takes this adjustment into account on its adjustment-year return by adjusting the non-income item consistently with the adjustment, to the extent the non-income item appears on the adjustment-year return without regard to the adjustment.

Two comments were received regarding the rules for taking into account adjustments to non-income items in the partnership's adjustment year in situations where the adjustments to non-income items are adjustments that do not result in an imputed underpayment under proposed §301.6225-3(b)(8). Both comments expressed concern that including an adjustment to a non-income item, such as an asset, in the imputed underpayment could result in recognition of gain, in the form of the imputed underpayment on the adjustment, prior to the disposition of the asset. One comment also expressed concern that it could result in double tax in situations where a non-income item is adjusted at the partnership level under the centralized partnership audit regime and at the partner level in situations where a special enforcement provision is utilized. According to the comment, the double tax would occur because the partner would pay tax on the adjustment in the partner-level proceeding and the partnership would pay an imputed underpayment on the same adjustment in a partnership examination. The comment noted that it was unclear whether the partnership must also recognize gain on that adjustment in addition to adjusting the non-income item on the partnership's adjustment year return. One of the comments recommended removing proposed §301.6225-3(b)(8) in its entirety. However, the comment seemed to focus primarily on the inclusion of non-income items in the calculation of the imputed underpayment, which is not something that is the subject of proposed §301.6225-

3(b)(8). Therefore, that comment's concerns on that issue are addressed more fully in section 2.B of this preamble.

One of the comments also requested that the rule be clarified to note that the partnership would not recognize gain in the adjustment year as a result of taking into account the adjustment to the non-income item that was an adjustment that did not result in an imputed underpayment. Finally, one comment requested that cross-references in the example be changed to refer to §§301.6225-1(d) and (f) in their entirety and requested additional examples illustrating how other adjustments to non-income items are taken into account on the adjustment year return.

With regard to the comment's concern about the potential for double tax, if an item is adjusted both in an examination of the partnership and of a partner, §301.6241-7(i) provides that an item will not be adjusted at the partner level if the partner can demonstrate that the adjustment was previously taken into account by the person in an examination under the centralized partnership audit regime (for example, by filing an amended return as part of a request to modify the imputed underpayment). Also, an item will not be adjusted at the partner level if the partner demonstrates that the adjustment was included in an imputed underpayment paid by the partnership or pass-through partner for a taxable year in which the partner was a reviewed year partner but only to the extent the adjustment exceeds the original amount reported by the partnership to the partner (that is, the partner needs to have reported the original amounts from the partnership first). In addition, if the partner-level proceeding concludes prior to the partnership-level proceeding, the partnership may request modification of the imputed underpayment for any adjustment previously taken into account at the partner level. Accordingly, in situations where an item is adjusted both in a partner-level examination and a partnership-level examination, the adjustments will

not result in double tax because these rules provide for the exclusion of any potential double tax in the examination that concludes later.

The comments also had concerns about gain recognition as a result of adjusting the non-income item in the adjustment year when the adjustment is an adjustment that does not result in an imputed underpayment. There is nothing in the centralized partnership audit regime that would require the partnership to recognize gain in the adjustment year when the partnership adjusts a non-income item as a result of taking into account adjustments that do not result in an imputed underpayment.

Proposed §301.6225-3(b)(8) provides that the partnership takes an adjustment to a non-income item into account by adjusting the non-income item on its adjustment year return. As the example in proposed §301.6225-3(d)(3) demonstrated, in the case of an adjustment to the basis of an asset, the partnership would adjust its basis in the asset in the adjustment year. To avoid confusion, the example has been modified to clarify that the reduction in the basis of the asset only requires the partnership to recognize income or gain in situations where income and gain would be recognized. One comment also requested additional examples demonstrating how adjustments to other items such as liabilities and capital account adjustments are taken into account. In response to the comment, Example 4 is added to §301.6225-3(d) to demonstrate how adjustments to liabilities are taken into account when they are adjustments that do not result in an imputed underpayment. Another example, Example 5, is also added to §301.6225-3(d) in response to the public comment to demonstrate how filing an amended return as part of modification applies when there are adjustments to non-income items. In addition, the recommendation that the cross-references in the example be modified is also adopted and the cross-references are changed where they appear in the example.

One comment expressed concern about how partnerships would be able to comply with proposed §301.6225-3(b)(8) when filing their adjustment year returns. The

comment noted that partnerships have different software, advisors, and levels of sophistication and, therefore, the rule might not be consistently applied among partnerships. The comment expressed a concern that proposed §301.6225-3(b)(8) does not provide a clear and administrable standard as to when to include a non-income item adjustment on the partnership's adjustment year return. The comment expressed concern that taking into account adjustments to non-income items on the partnership's adjustment year return could preclude items that otherwise could never be reported and provided examples of items under section 199A.

Proposed §301.6225-3(b)(8) endeavors to provide clear, bright-line rules on how to account for adjustments to non-income items that must be taken into account on the partnership's adjustment year return because they did not result in an imputed underpayment. Proposed §301.6225-3(b)(8) provides rules on what to do if the non-income item is still included on the partnership's adjustment year return and rules for what happens if it is not included, as well as an example of how the rule works. The nature of non-income items precludes a regulation that could individually account for all types of non-income items because non-income items by their definition vary widely. To encompass all the types of non-income items that could be adjusted in the centralized partnership audit regime, it is necessary for the rule to be broad and apply to numerous types of non-income items. Although the Treasury Department and the IRS take seriously concerns regarding inconsistent application of provisions, varying levels of sophistication, and differences in interpretation of statutes or regulations by software or advisors, proposed §301.6225-3(b)(8) provides necessary guidance to taxpayers while appropriately balancing administrability concerns.

The comment about whether proposed §301.6225-3(b)(8) would preclude the reporting of some items is unclear. If an adjustment is an adjustment that does not result in an imputed underpayment, it is required to be taken into account on the

partnership's adjustment year return under section 6225(a)(2). Therefore, those adjustments are accounted for on the adjustment year return.

As non-income items are required to be included in the calculation of the imputed underpayment, there must be rules regarding how to take those adjustments into account on the adjustment year return if they are adjustments that do not result in an imputed underpayment. Without the rule contained in proposed §301.6225-3(b)(8), partnerships would be left with no guidance as to how or when to take those adjustments into account. For this reason and for all the previous reasons, the recommendation to remove proposed §301.6225-3(b)(8) is not adopted.

One comment requested an example demonstrating how adjustments to capital accounts are taken into account if they are adjustments that do not result in an imputed underpayment. These regulations do not address any effect on partner basis and capital accounts. As a result, the comment is beyond the scope of these regulations.

B. Adjustments to non-income items in the calculation of the imputed underpayment

Section 6225 provides specific rules on how to compute the imputed underpayment, which is a liability of the partnership. Under section 6225(b), if adjustments are made to a partnership-related item, those adjustments are appropriately netted, and the highest rate under section 1 or 11 is applied as part of the calculation of the imputed underpayment. Non-income items are included in the definition of "partnership-related item." See section 6241(2)(B)(i) (noting that a partnership-related item includes any item or amount relating to liabilities of the partnership); §301.6241-1(a)(6)(v)(C), (D), and (E). Accordingly, as non-income items are partnership-related items, adjustments to non-income items are appropriately included in the calculation of the imputed underpayment as section 6225 does not limit which adjustments to partnership-related items are included in the calculation.

The November 2020 NPRM did not propose any changes to the definition of positive adjustments in §301.6225-1(d)(2)(iii), to the formula for calculating the imputed underpayment under §301.6225-1(b), or to §301.6225-1(a)(1), which provides that all adjustments to partnership-related items are included in the calculation of the imputed underpayment. In addition, no changes were proposed to the definition of partnership-related item in §301.6241-1(a)(6)(ii), which includes examples of non-income items as partnership-related items. Accordingly, comments regarding whether a non-income item should be included in the calculation of the imputed underpayment are outside the scope of this regulation and any changes to those provisions would need to be proposed in a separate NPRM. However, the Treasury Department and the IRS have attempted to respond to the comments on this issue within the scope of the November 2020 NPRM.

Two comments were received on the inclusion of non-income items in the calculation of the imputed underpayment. Both comments recommended that all adjustments to non-income items should not be taken into account in determining whether there is an imputed underpayment or that the adjustment to the non-income items should be treated as zero in the computation.

One comment expressed a concern that including adjustments to non-income items in the calculation of the imputed underpayment would fail to reflect accurately the tax impacts of the adjustments and that the imputed underpayment could be far greater than the partners' aggregate chapter 1 tax liability, which the comment said the imputed underpayment is intended to approximate. The comment said this discrepancy would discourage partnerships from filing administrative adjustment requests (AARs) especially given that more and more items are being reported by partnerships. The comment expressed concern that the ability to push out the adjustments under section 6226 does not mitigate or alleviate these concerns.

Both comments expressed concern that an adjustment to a non-income item, such as an adjustment to the basis of an asset, could give rise to a taxable adjustment without a corresponding disposition, realization, or recognition event upon which gain or loss would be determined. One comment also had concerns that including an adjustment to a non-income item in the imputed underpayment would effectively require the partnership to recognize gain prior to when the partnership would otherwise be required to recognize gain under the Code. One comment stated that there is nothing in the Code or in the legislative history of the centralized partnership audit regime that would indicate Congress intended that the IRS could cause a recognition event where one had not occurred. The Treasury Department and the IRS note that there is no legislative history of subchapter C of chapter 63 but agree that there is nothing in subchapter C of chapter 63 that specifically mentions recognition events. However, as discussed later, under the centralized partnership audit regime, the inclusion of an adjustment to a non-income item in an imputed underpayment is not, and does not require, a recognition event.

With regard to the comment that the tax is paid early on non-income items, the comment is correct that, by paying an imputed underpayment on an adjustment to a non-income item, in some circumstances the partnership will effectively pay a tax on the change in the non-income item in situations where the partnership would not yet have recognized income aside from the partnership examination. Under section 6225, the partnership is liable for an imputed underpayment on any adjustments to partnership-related items, which is defined under section 6241 as any item with respect to the partnership that is relevant to determining the tax liability of any person under chapter 1 of the Code, including a liability of the partnership.

Accordingly, the imputed underpayment under the centralized partnership audit regime is not designed to be the exact amount of the tax liability that would have been

paid by the partners, nor is it a substitute for partner tax liability. Rather, it is an entity-level liability of the partnership alone computed by reference to any adjustments made to partnership-related items, regardless of whether those adjustments would have actually resulted in a tax liability to any particular partner. Therefore, given that adjustments are made to a specific taxable year, the adjustments could result in an imputed underpayment in situations where no income would have been recognized if the item had been correctly reported originally. But the adjustments and the imputed underpayment are not themselves realization or recognition events; they are adjustments to partnership-related items that are taken into account in calculating an imputed underpayment under the centralized partnership audit regime.

To provide the partnership with an opportunity to mitigate any inconsistency that may result with the computation of the imputed underpayment, the partnership can request to modify the imputed underpayment or may elect to push out the adjustments to its reviewed year partners. When taking into account an adjustment to a non-income item as part of filing of an amended return or calculating the additional reporting year tax under section 6226, an adjustment to a non-income item would only result in additional tax if that adjustment would have resulted in additional tax on the partner's original tax return had the item been correctly reported by the partnership on its original return for the reviewed year or any intervening year. For example, assume the basis in an asset was adjusted and, subsequent to the reviewed year but prior to the adjustment year, a partner received that asset in a distribution and disposed of that asset. In that case, an adjustment to the partnership's basis in an asset may affect the amount of tax the partner would have paid if the item had been correctly reported. As a result, in this example, the additional reporting year tax for that partner likely would be affected by the basis adjustment.

As mentioned previously, two comments requested that adjustments to non-income items be excluded from the calculation of the imputed underpayment or that those adjustments be treated as zero. As previously discussed, the imputed underpayment is an entity-level liability calculated on all of the adjustments to partnership-related items, and the highest rate is applied regardless of what the tax consequences would have been had the partners correctly taken into account the adjustments in the reviewed year. As a result, in some instances the centralized partnership audit regime shifts an adjustment, and its tax consequences, into a different year than the year to which the adjustment relates. For example, adjustments that do not result in an imputed underpayment are taken into account in the adjustment year instead of the reviewed year. In other words, there are many aspects of the centralized partnership audit regime enacted by Congress that result in income, gain, loss, deduction, or credit, and any taxes on those items, being recognized or taken into account in taxable years other than in the taxable year where the item would have been reported if the centralized partnership audit regime did not apply.

To alleviate this difference, the centralized partnership audit regime offers partnerships choices that would modify or eliminate the imputed underpayment and would make the underpayment amount closer to the amount of tax that would have been paid if the partners had reported the proper amounts of items in the correct taxable year. For example, the partnership may request modification of the imputed underpayment, including modification of any adjustments that do not result in an imputed underpayment, or may elect to push out the adjustments to its reviewed year partners under section 6226. In addition, §301.6225-1(b)(4) provides that the IRS and partnerships may treat an adjustment as zero solely for purposes of calculating the imputed underpayment in situations where multiple positive adjustments are related to, or result from, one another. Therefore, the recommendation to remove adjustments of

non-income items from the calculation of the imputed underpayment or to treat those adjustments as zero in calculating the imputed underpayment in all situations is not adopted.

In addition to the comments on the inclusion of non-income items in the calculation of the imputed underpayment, one comment was received on proposed §301.6225-1(b)(4), which provides the rules for treating an adjustment as zero solely for purposes of computing the imputed underpayment in certain situations. The comment recommended extending the rule in proposed §301.6225-1(b)(4), that allows one adjustment to be treated as zero solely for purposes of calculating the imputed underpayment, if the adjustment is related to or results from an adjustment to an item of income, gain, loss, deduction, or credit to persons other than the IRS. As stated in the preamble to the November 2020 NPRM, the sentence added to §301.6225-1(b)(4) that provides that a partnership may treat an adjustment to a non-income item as zero for purposes of computing the imputed underpayment was proposed to be expanded to provide for a broader application, including to allow partnerships to utilize this rule.

In response to the comment that the language is unclear, the language of proposed §301.6225-1(b)(4) is modified to clarify that this provision applies to both the IRS and partnerships, and the rule has been broadened further. As modified, §301.6225-1(b)(4) as set forth in this Treasury decision provides that if any positive adjustment is related to, or results from, a second positive adjustment, a partnership may treat one of the positive adjustments as zero solely for purposes of computing the imputed underpayment unless the IRS determines that the adjustment should not be treated as zero. With this change, a partnership may treat an adjustment to a non-income item as zero if the adjustment to the non-income item is related to, or results from, another adjustment to a non-income item. However, this rule does not allow the partnership to treat an adjustment as zero if one adjustment is positive and one is

negative. For example, if a partnership changes an ordinary loss to a capital loss, which results in a positive adjustment to ordinary income and a negative adjustment to capital loss, the partnership could not treat the negative adjustment to capital loss as zero for purposes of calculating the imputed underpayment. This change provides more relief to partnerships and more closely aligns with the intended purpose of this rule.

One comment recommended that the phrase “unless the IRS determines that the adjustment should be included in the imputed underpayment” be removed from §301.6225-1(b)(4). It is unclear whether this recommendation was made to provide clarity that the provision also applied to determinations made by partnerships or if this recommendation was in addition to that comment. To the extent the comment was about clarifying that §301.6225-1(b)(4) applied to determinations made by partnerships as well as the IRS, as discussed previously, additional language has been added to the provision to make this clear. To the extent that this comment is an additional recommendation, the comment is not adopted. Because partnerships may treat an adjustment as zero for purposes of calculating the imputed underpayment, there may be times when the partnership should not have treated the adjustment as zero. Accordingly, the IRS needs to be able to determine that the partnership’s calculation is accurate.

The comment also requested that a cross-reference to §301.6225-1(b)(4) be added to the regulations under section 6227 to clarify that the provision may be used in AARs. Section 301.6227-2(a)(1) provides that the calculation of an imputed underpayment as part of the filing of an AAR is done in accordance with §301.6225-1, which would include §301.6225-1(b)(4). Therefore, additional clarification is not needed and adding a cross-reference to one portion of the entire regulation that is cited may cause confusion regarding whether the other provisions in §301.6225-1 are applicable.

One comment recommended that if the partnership did not include any adjustments to non-income items in calculating an imputed underpayment as part of an AAR, the rule should provide that the partnership will not be subject to penalty. Nothing in the centralized partnership audit regime prohibits a partnership from raising a defense (such as reasonable cause) to an asserted penalty if that penalty is subject to such a defense. However, if partnerships would never be subject to a penalty for failing to include adjustments to non-income items in the calculation of the imputed underpayment, this would discourage partnerships from including non-income items in the calculation as there would not be a penalty for the IRS to utilize to enforce correct reporting of partnership-related items. The penalty incentivizes proper reporting and removing the penalty's application here would negatively affect tax compliance. Therefore, this comment is not adopted.

In addition, one comment also recommended that any adjustment to a non-income item that affects the basis of partnership assets should be included under the rules of proposed §301.6225-4 and not under the provisions of computing the imputed underpayment on adjustments to partnership-related items. This comment is not adopted. Section 301.6225-1 provides rules for the calculation of the imputed underpayment. Adjustments to a partnership's reporting of its non-income items on its return are included within the calculation of the imputed underpayment as are all adjustments to partnership-related items. Accordingly, §301.6225-1, and not proposed §301.6225-4, is the proper location for rules governing the calculation of the imputed underpayment.

Finally, one comment recommended removing §301.6225-1(d)(2)(iii)(B), which provides that an adjustment that cannot be allocated under section 704(b) is treated as a positive adjustment or a credit, as appropriate, if the adjustment could result in an increase in an item of income, gain, loss, deduction, or credit. The comment stated that

this rule also addresses the same issue as §301.6225-1(b)(4), which provides that an adjustment may be treated as zero for purposes of calculating the imputed underpayment if that adjustment is included within another adjustment and it would not be appropriate to include both adjustments in the calculation. The comment stated that both address adjustments to non-income items that are taken into account in calculating the imputed underpayment and, therefore, §301.6225-1(d)(2)(iii)(B) is duplicative. Although the comment noted that it is duplicative, the comment recommended that this provision be amended to provide that items that cannot be allocated under section 704(b) are not taken into account in computing the imputed underpayment.

As previously mentioned, comments requesting that non-income items be excluded completely (or always treated as zero) from the calculation of the imputed underpayment are not adopted. Section 301.6225-1(d)(2)(iii)(B) does not serve the same purpose as §301.6225-1(b)(4). Section 301.6225-1(d)(2)(iii)(B) provides that adjustments to items that are not allocated under section 704(b) are treated as positive adjustments or credits, whichever is appropriate. Section 301.6225-1(b)(4) provides that adjustments may be treated as zero solely for purposes of calculating the imputed underpayment if that adjustment is related to, or results from, another adjustment. Section 301.6225-1(b)(4) does not apply to adjustments that are not related to, or result from, another adjustment and, after amendment, it applies to all positive adjustments, not just those that are not allocated under section 704(b). Therefore, §301.6225-1(d)(2)(iii)(B) and §301.6225-1(b)(4) are not duplicative. Even though those provisions are not duplicative, the Treasury Department and the IRS agree that §301.6225-1(d)(2)(iii)(B) is duplicative of concepts in other provisions, such as the definition of positive adjustment. Accordingly, the comment recommending removing §301.6225-1(d)(2)(iii)(B) is adopted. Because §301.6225-1(d)(2)(iii)(B) is removed in these

regulations, former §301.6225-1(d)(2)(iii)(A) is renumbered to be §301.6225-1(d)(2)(iii).

No changes were made to the content of the paragraph.

3. Cease to Exist

One comment was received on the proposed changes to §301.6241-3. That section provides rules implementing section 6241(7), which authorizes the Secretary of the Treasury or her delegate (Secretary) to prescribe rules for situations where a partnership (or partnership-partner) has ceased to exist prior to a partnership adjustment taking effect.

A. Guidance under section 6232(f)

The comment recommended not finalizing any of the proposed changes to §301.6241-3 until the IRS issues guidance under section 6232(f), which provides rules for the IRS to assess amounts due to failure to pay imputed underpayments. The comment reasoned that guidance under section 6232(f) will provide insight into how the provisions under §301.6241-3 should be coordinated with section 6232(f). As an alternative, the comment recommended not finalizing the proposed changes to §301.6241-3(c), which provides when partnership adjustments take effect. The comment is not clear as to why the proposed changes to when partnership adjustments take effect causes concern. The comment noted that if the proposed changes were finalized, partnerships would be subject to the discretion of the IRS not only as to whether the partnership has ceased to exist but also when the adjustments take effect.

As stated in the preamble to the November 2020 NPRM, some of the proposed changes to §301.6241-3 are needed so that the rules implementing section 6241(7) do not prevent the IRS from using its assessment power under section 6232(f). Unlike some other provisions in the centralized partnership audit regime that require regulations or other guidance to be effective, section 6232(f) is self-executing and does not require the IRS to issue guidance before the provision may be used. Section

6241(7) provides that if a partnership ceases to exist prior to the partnership adjustments taking effect, then the former partners are to take into account the adjustments under regulations prescribed by the Secretary.

Accordingly, as written, section 6241(7) requires its application if its conditions are met. Prior to proposed amendment, §301.6241-3 provided that adjustments did not take effect until the partnership fully paid all amounts due under the centralized partnership audit regime but no later than the expiration of the collections period of limitations. Therefore, if the IRS determined that a partnership ceased to exist, section 6241(7) would be the only provision that could be used, precluding the use of section 6232(f). There is no reason why the IRS should be prevented from using the self-executing rules of section 6232(f) prior to the issuance of guidance under section 6232(f). Therefore, this comment is not adopted.

B. When adjustments take effect

As previously mentioned, the comment recommended that the proposed changes to when partnership adjustments take effect not be finalized. The proposed change is needed to allow the IRS to utilize section 6232(f) and not be foreclosed from doing so by section 6241(7) in situations where the partnership has ceased to exist.

The comment seemed to express concern that the revised definition would give the IRS greater discretion over which provision would apply and that, as a result, the changes should not be finalized. As stated earlier, the November 2020 NPRM proposed to change when partnership adjustments take effect from when the partnership has fully paid any amounts due under the centralized partnership audit regime to when the IRS and the partnership enter into a settlement agreement, when an AAR is filed, or if the adjustments become finally determined under §301.6226-2(b)(1), which is when a court decision becomes final or when the notice of final partnership adjustment (FPA) is mailed if no petition is filed under section 6234.

This change does not provide the IRS with more discretion as the IRS has limited control over when the adjustments take effect. Although the comment seems to presume that a partnership has complete control over when it pays all of the amounts due, if the IRS is utilizing collection tools such as a levy, the balance due could become fully paid outside of the partnership's control. Likewise, although the IRS has some control over when it mails an FPA (influenced in part by whether a partnership agrees to an extension of the period of limitations under section 6235), the IRS has no control over whether the partnership files a petition in response to the FPA, when a court decision becomes final, when the partnership files an AAR, or if the partnership enters into a settlement with the IRS. Therefore, because §301.6241-3 of the final regulations should not create a situation where it precludes the IRS from utilizing section 6232(f) by providing that adjustments do not take effect until the amount due from those adjustments is paid, the comment is not adopted.

C. Currently not collectible

Under proposed §301.6241-3(b), a partnership ceases to exist if the IRS determines that the partnership terminates under section 708(b)(1) or the partnership does not have the ability to pay, in full, any amount that may be due under the centralized partnership audit regime. It further provides that if a partnership's account is "currently not collectible" according to IRS records, then it is deemed to not have the ability to pay in full. Previously a partnership was considered to have ceased to exist if the IRS determined that the partnership terminated under section 708(b)(1) or the partnership does not have the ability to pay in full under the centralized partnership audit regime. If a partnership is "currently not collectible," it does not have the ability to pay in full, which is why the amendment to §301.6241-3(b) was proposed.

The comment recommended that a definition of "currently not collectible," which is used as part of the definition of when a partnership may cease to exist, be added to

§301.6241-7 so that partnerships will have clear notice of when the IRS would make a determination that the partnership has ceased to exist under this provision. The comment noted that “currently not collectible” is a term of art used by the IRS and that the Internal Revenue Manual (IRM) sets forth procedures to determine if a taxpayer is “currently not collectible.”

As an initial matter, the Treasury Department and the IRS note that, under §301.6241-3(b), a partnership may not have the ability to pay in full but not be “currently not collectible.” As provided in §301.6241-3(b), if the IRS has determined a partnership is “currently not collectible” then it will be deemed not to have the ability to pay in full. The comment is correct that the term “currently not collectible” is a term of art used by the IRS. The proposed change to the definition of cease to exist under §301.6241-3(b)(1) to use the term “currently not collectible” is intended to be the same as “currently not collectible” already in use by the IRS in other contexts. The centralized partnership audit regime concerns the making of adjustments to partnership-related items and is, therefore, not the proper place for new rules regarding collectability generally. As the comment correctly noted, there is an entire section in the IRM that provides standards and procedures for determining whether a taxpayer is “currently not collectible.” These procedures have been in place for several years and provide a familiar and well-known standard for both the IRS and taxpayers. Having multiple standards or definitions for whether a taxpayer is “currently not collectible” would result in uncertainty for the IRS and taxpayers. Therefore, this comment is not adopted.

D. Coordination with elections under section 6226, requests for modification, and payment of the imputed underpayment

As previously stated, section 6241(7) provides that if a partnership ceases to exist prior to when any adjustments take effect, the former partners of the partnership must take into account the adjustments under regulations prescribed by the Secretary.

One comment expressed concern that it was unclear whether a partnership that has ceased to exist may make an election to push out the adjustments under section 6226, request modification of the imputed underpayment under section 6225(c), or pay the imputed underpayment instead of the former partners taking the adjustments into account using the rules in §301.6241-3. The comment expressed concern that the IRS could determine a partnership ceased to exist prior to the partnership having an opportunity to utilize any of these provisions and that may prevent the partnership from utilizing any provisions. The comment recommended that the rule be clarified to provide that a partnership may make an election to push out the adjustments under section 6226, request modification of the imputed underpayment under section 6225(c), or pay the imputed underpayment even if the partnership has ceased to exist. This comment is adopted for the following reasons.

The rules implementing section 6241(7) were never intended to prevent a partnership from making an election to push out the adjustments under section 6226, requesting modification of the imputed underpayment under section 6225(c), or paying the imputed underpayment. Section 6241(7) is a tool the IRS may use in situations where it is unclear whether the partnership will be able to pay any amounts due resulting from the partnership adjustments to protect the ability to collect tax due as a result of the partnership adjustments. Therefore, it is not intended to prevent a partnership from reducing or fully paying its liability or shifting the liability to its former partners as it could if it had not ceased to exist. In addition, one of the two criteria for determining whether a partnership has ceased to exist is that the partnership does not have the ability to fully pay any amounts due under the centralized partnership audit regime. If the partnership has the ability to fully pay all amounts due, the partnership would not have ceased to exist under that criteria.

In response to the comment, a sentence is added to the end of §301.6241-3(a)(1), which provides that a determination that a partnership has ceased to exist does not prohibit the partnership from requesting to modify the imputed underpayment under section 6225(c). The ability to request modification of the imputed underpayment is not dependent on whether the partnership is paying the imputed underpayment or will elect to push out the adjustments to its partners and, therefore, is not dependent on whether the former partners must take into account the adjustments.

In addition, in response to the comment, a sentence is added to the end of §301.6241-3(b)(3), which provides for limitations on the IRS's ability to determine that a partnership has ceased to exist. The new sentence provides that a determination that a partnership has ceased to exist is not effective if the partnership has made a valid election under section 6226 to push out the adjustments or has fully paid all amounts due under the centralized partnership audit regime within ten days of notice and demand for payment. This addition protects the IRS's ability to utilize the rules under section 6241(7) while still clarifying that a partnership may make an election under section 6226 or pay the imputed underpayment and any applicable penalties and interest.

E. Former partners

Under proposed §301.6241-3(d), the former partners of a partnership are the partners from the last taxable year for which the partnership filed a return under section 6031, the partners from any AAR filed by the partnership, or the partners from a final determination that is binding on the partnership. Prior to the proposed changes, the former partners of the partnership were the partners during the adjustment year or, if there are no adjustment year partners, the partners of the partnership during the last taxable year for which the partnership filed a return under section 6031.

The comment recommended that the proposed changes to the definition of “former partners” under §301.6241-3(d) should not be made as the proposed change to the definition was related to the change to the determination of when the adjustments take effect, which the comment previously recommended not be made. Although, as stated in section 3.B of this preamble, the comment to retain the existing definition of when partnership adjustments take effect is not adopted, the Treasury Department and the IRS have decided not to finalize the proposed changes to §301.6241-3(d).

4. Comments on the Special Enforcement Provisions

Three comments were received on several of the provisions proposed under §301.6241-7 that implement section 6241(11) regarding the treatment of special enforcement matters. A comment was made regarding whether these rules were consistent with the purpose of the centralized partnership audit regime’s clear directive that adjustments to partnership-related items be adjusted at the partnership level, not in a partner examination, and that any departure from that directive should be narrow and only exist where there is clear justification for the departure. Two comments suggested that the centralized partnership audit regime, including section 6235, does not suggest that the period of limitations at the partner level impacts the ability of the IRS to make adjustments to partnership-related items and that no extensions of the period of limitations should be made outside of those expressly provided by Congress in section 6235.

Under section 6241(11), Congress prescribed that in the case of partnership-related items that involve special enforcement matters, the Secretary may prescribe regulations providing that the centralized partnership audit regime does not apply to those partnership-related items and that those items are subject to special rules for assessment and collection as the Secretary determines to be necessary for the effective and efficient enforcement of the Code. Integral to the concept that the Secretary can

determine that the centralized partnership audit regime (or portions of it) does not apply to certain partnership-related items is the ability to adjust those partnership-related items outside of the centralized partnership audit regime.

Additionally, inherent in the ability to subject items to special rules for assessment and collection is the ability to prescribe rules for assessment that differ from existing rules, including section 6235. If the centralized partnership audit regime does not apply to an item then that item may only be adjusted using the rules that apply to partnerships that have made an election out of the centralized partnership audit regime and not using any of the rules contained in subchapter C of chapter 63. For example, if the centralized partnership audit regime does not apply to an item, the item could be adjusted on the return of the partner and the section 6235 period of limitations would not apply to that item. Instead, as for partnerships that have elected out of the centralized partnership audit regime, the operative period of limitations is the partners' period of limitations on making assessments. Because section 6241(11) provides that the IRS may provide that the centralized partnership audit regime does not apply to certain items and that there are special rules for assessment and collection, the IRS may prescribe special rules that impact or rely upon the partners' periods of limitations on assessment.

Therefore, although the centralized partnership audit regime provides that adjustments are made at the partnership level based on the partnership's period of limitations, Congress, by enacting section 6241(11), contemplated that there would be times when the centralized partnership audit rules did not apply. Accordingly, any special enforcement provision that adjusts partnership-related items outside of the centralized partnership audit regime or provides special rules governing the period of limitations on assessment when items are adjusted outside of the centralized

partnership audit regime is not inconsistent with Congress's intent. Rather, it is consistent with the intent of Congress as expressly provided in section 6241(11).

A. Partnership-related items that underlie adjustments to items that are not partnership-related items

Three comments were received on the proposed special enforcement rule under §301.6241-7(b) that would allow the IRS to make determinations regarding partnership-related items as part of an adjustment to an item that is not a partnership-related item in situations where the treatment of the partnership-related item on the partnership return is based, in whole or in part, on information provided by the person under examination. The rule in proposed §301.6241-7(b) was previewed in Notice 2019-06, which was made available to the public on December 20, 2018. Although Notice 2019-06 requested comments, no comments were received on this rule.

All comments recommended that proposed §301.6241-7(b) be removed in its entirety. Two comments expressed concern that adjustments made in a partner examination could affect the other partners in the partnership and the partnership itself. One comment stated that the proposed rule appears to be inconsistent with Congress's intent that adjustments to partnership-related items be determined at the partnership level. Two comments stated that the proposed rule could be interpreted broadly to encompass partners involved in the preparation of the return.

One comment stated that other provisions in the centralized partnership audit regime already address the same issue as proposed §301.6241-7(b). That comment stated that the ability for partners to file an amended return during the modification process, the ability for the partnership to elect to push out the adjustments, and the ability to create a specific imputed underpayment for a single or small group of partners makes proposed §301.6241-7(b) redundant and unnecessary and, therefore, should be withdrawn. The comment stated that these provisions already allow the IRS to make a

partnership adjustment that involves a single or limited number of partners. The comment also stated that proposed §301.6241-7(b) is inconsistent with the foundational principles of the centralized partnership audit regime that provides the default rule that the partnership is liable for any tax resulting from a partnership adjustment.

Under proposed §301.6241-7(b), the IRS may make determinations regarding partnership-related items as part of an adjustment to an item that is not a partnership-related item. Pursuant to this rule, the IRS is making an adjustment to an item that is not a partnership-related item. As part of making an adjustment to that item that is not a partnership-related item, the IRS may make determinations about a component of that item that is not a partnership-related item when that component happens to be a partnership-related item. But the item actually being adjusted on the partner's return is an item that is not a partnership-related item. For example, this situation may arise when a partner contributes an asset to the partnership in exchange for an interest in the partnership and the partner then sells its interest in the partnership. If the IRS disagrees with the amount of the partner's contribution to the partnership, the adjustment the IRS actually makes is to the partner's outside basis in its partnership interest and the gain the partner reported on the sale of its partnership interest that is reported on the partner's return. The IRS is not adjusting the contribution to the partnership or the partnership's basis in the contributed asset so, therefore, nothing on the partnership's return or anything maintained in its books and records changes as a result of the adjustment made to the partner's return.

Because the IRS is adjusting an item that is not a partnership-related item during an examination of the partner, rules regarding the creation of a specific imputed underpayment, a partner's filing of an amended return during modification, or the partnership making an election under section 6226 do not address the special enforcement matter underlying proposed §301.6241-7(b). To utilize these provisions,

the IRS would have to remove the item that is not a partnership-related item that is affected by partnership-related items from the partner examination it currently has open. Then, the IRS would have to open a separate examination of the partnership just to make an adjustment to a partnership-related item (or portion thereof) the reporting of which is based in whole or in part on information provided by a specific partner or small group of partners who were already under examination by the IRS. This is the exact inefficiency proposed §301.6241-7(b) was designed to alleviate.

As previously stated, section 6241(11) by its express terms provides that rules may be created where the centralized partnership audit regime (or portions of it) would not apply to partnership-related items. Therefore, while there are foundational principles in the centralized partnership audit regime, such as the default rule that a partnership pays tax on partnership adjustments, section 6241(11) expressly allows those foundational principles to be inapplicable for special enforcement matters.

Although all comments recommended that the provision be removed in its entirety, one recommended that if it is retained, the rule should be limited to adjustments that would not impact the other partners at all and another recommended that the applicability date of the rule not be the date that Notice 2019-06 was issued and that the accompanying example be modified.

Under proposed §301.6241-7(h)(2), determinations about partnership-related items that are made outside of the centralized partnership audit regime are not binding on any person who was not a party to the proceeding. Accordingly, if none of the other partners or the partnership become parties to the proceeding, no determination from that proceeding is binding on them or would otherwise affect them. This is similar in result to an examination of a partner in a partnership that elected out of the centralized partnership audit regime. Although the IRS may not make corresponding adjustments to the partnership's items or to items of other partners not parties to the proceeding

without opening another proceeding, nothing prevents the partnership or the other partners from taking any action to adjust those items.

To provide clarity in response to the comment, §301.6241-7(h)(2) has been modified to clarify that the partnership and the other partners are not bound to any determination regarding a partnership-related item resulting from the partner-level examination and nothing in §301.6241-7 requires the partnership or other partners to adjust their returns. Section 301.6241-7(h)(2) has also been modified to provide further explanation of how determinations regarding partnership-related items outside of the centralized partnership audit regime affect others who are not parties to the proceeding. Section 301.6241-7(h)(2) has been modified to provide an example illustrating that if the partnership or any other partner does not become a party to a partner level proceeding conducted due to the application of any of the special enforcement rules (not just under §301.6241-7(b)) the partnership and the other partners are not bound to any determinations made in the partner-level proceeding. The example in §301.6241-7(b)(2) has been updated accordingly and has also been modified to provide clarity as to the items being adjusted in the example as a result of comments made at the public hearing.

The Treasury Department and the IRS also note that §301.6241-7(b) is very similar to §301.6222-1(c)(4), which provides rules for conducting a partner-level proceeding if the partner notifies the IRS of the partner's inconsistent treatment of partnership-related items. Like §301.6241-7(b), §301.6221-1(c)(4)(ii) provides rules for adjusting or determining partnership-related items in a partner-level proceeding and provides that the IRS may adjust the partnership-related item to be the correct treatment, even if that treatment is different than the partnership's treatment of the partnership-related item. As with §301.6241-7(b), §301.6222-1(c)(4)(ii) provides that any final decision in that partner-level proceeding is not binding on the partnership if the

partnership was not a party to the proceeding. The rule under §301.6241-7(b) is not unique in the centralized partnership audit regime.

Accordingly, the comments have been adopted to the extent they expressed concern about the effect on the partnership and the other partners as a result of determining partnership-related items as part of an adjustment to an item that is not a partnership-related item at the partner level. Nothing in these rules precludes the other partners or the partnership from taking any action they deem necessary, including requiring a partner to notify the partnership or the other partners of any examination involving any of the special enforcement provisions.

As mentioned previously, the comments expressed concern that the rule allowing the IRS to adjust partnership-related items outside of the centralized partnership audit regime as part of an adjustment to an item that is not a partnership-related item could be interpreted very broadly and could apply to a wide variety of partnership-related items and even to partners involved in the preparation of the partnership return. It is unclear from the comments how the rule could be interpreted broadly to apply to a wide variety of partnership-related items and a wide variety of persons.

For this rule to apply, all of the following conditions must be met: (1) a person other than the partnership must be under examination; (2) the IRS must propose an adjustment to an item that is not a partnership-related item; (3) a partnership-related item must be a component of that item that is not a partnership-related item; (4) determinations about that partnership-related item must be needed in order to adjust the item that is not a partnership-related item; and (5) the treatment on the partnership's return of the partnership-related item that is the component of the item that is not a partnership-related item being adjusted must be based, in whole or in part, on information provided by the person under examination. The information provided by the person under examination is that person's information, not the partnership's information

(that is, it is not something maintained in the partnership's books and records). A partner who prepares the partnership return would only be covered by this provision if that partner were under examination based on the partner's own tax return filings that required such adjustments, not based on the fact that the partner prepared the return. A partner that provides all of the information needed to prepare the partnership's return that is the partnership's information (for example, its transactions) would not be covered by the rule as the treatment on the partnership's return is not based on information provided by the partner but is based on the partnership's information. To avoid any confusion, in response to this comment, §301.6241-7(b)(1)(iii) is modified to clarify that the information provided by the partner that forms the basis of the reporting by the partnership must come from the partner's own books and records, not the books and records of the partnership.

Another comment recommended that if the rule is retained that the provision be clarified. Specifically, the comment recommended that the rule be clarified to provide: (1) when a determination regarding a partnership-related item is "part of" or "underlying" an adjustment to an item that is not a partnership-related item; (2) whether the person described in proposed §301.6241-7(b)(1)(i) is the same person as in proposed §301.6241-7(b)(1)(ii) and (iii); (3) whether the determination regarding a partnership-related item occurs before or after the IRS determines that the centralized partnership audit regime does not apply to that partnership-related item; (4) a definition of "non-partnership-related item"; and (5) in the example, whether some of the facts are determinative of the outcome.

Regarding the comments about clarifying the meaning of "part of" and "underlying," these terms do not have a special meaning for purposes of the centralized partnership audit regime and should be read using the ordinary meaning of those words. As these words do not have a special meaning for purposes of the centralized

partnership audit regime, this comment is not adopted. With regard to defining “non-partnership-related item,” the comment is adopted by removing the term “non-partnership-related item.” Instead, the final rules refer to “items that are not partnership-related items” when referring to items that do not meet the definition of a partnership-related item.

Proposed §301.6241-7(b)(1)(i) provides that there must be an examination of a person who is not the partnership. Proposed §301.6241-7(b)(1)(ii) and (iii) refer to “the” person whose return is under examination and not “a” person who is under examination. No other persons, other than the partnership, are referred to in proposed §301.6241-7(b)(1). As there is only one person who is under examination mentioned in proposed §301.6241-7(b)(1), it is the same person in subparagraphs (i), (ii), and (iii) of proposed §301.6241-7(b)(1). As there is only one person under examination that is mentioned, the provision has been clarified to prevent any confusion by clarifying that the person described in §301.6241-7(b)(1)(ii) and (iii) is the same person referred to in §301.6241-7(b)(1)(i). Accordingly, the comment to clarify whether the person referred to in proposed §301.6241-7(b)(1)(ii) is the same as the person referred to in proposed §301.6241-7(b)(1)(iii), is adopted.

It is unclear what the concern is regarding the comment requesting clarity about whether the determination regarding a partnership-related item is made by the IRS before or after the IRS chooses to make other determinations regarding that partnership-related item outside of the centralized partnership audit regime. Before the IRS makes a determination that a partnership-related item may be adjusted or determined outside of the centralized partnership audit regime under §301.6241-7, the general rule of section 6221 applies and adjustments to partnership-related items must be made under the centralized partnership audit regime. Therefore, a partnership-

related item cannot be adjusted or determined outside the centralized partnership audit regime until after the IRS makes a determination under §301.6241-7.

A decision to apply §301.6241-7 is in itself the determination regarding whether adjustments to a partnership-related item may be made outside of the centralized partnership audit regime. The decision under §301.6241-7 does not itself make a determination regarding a partnership-related item. If the IRS decides that a determination should be made outside of the centralized partnership audit regime in accordance with §301.6241-7, the IRS then makes the determination as part of the partner's examination. Because additional clarification is unnecessary the comment is not adopted.

With regard to whether some of the facts in the example are determinative of the outcome, the facts that the comment mentions (no liability or activity) are there to prevent confusion over whether the partner's outside basis would have changed after the partner made the initial contribution to the partnership in exchange for an interest in the partnership. Accordingly, the facts are determinative not of the rule being illustrated in the example but of the amounts used in the example. Without those facts it could be unclear why the partner's basis on June 9, 2019, is the same as it was on June 1, 2018.

The comment also asserts that "the adjustment to the non-partnership-related item results in the adjustment to the partnership-related item." It is unclear what the comment is referring to. The adjustment being made in the example is to an item that is not a partnership-related item, which therefore does not result in an adjustment to a partnership-related item at the partnership level. The adjustment is being made at the partner level during an examination of the partner and it is not binding on the partnership in the same way that an adjustment to the return of a partner in a partnership that was not subject to the centralized partnership audit procedures would not be binding on that partnership. However, the IRS is not precluded from

commencing a partnership examination to effect a consistent adjustment. As explained previously in the preamble, no adjustment to a partnership-related item on the partnership's return or in the partnership's books and records is made when the IRS makes a determination regarding a partnership-related item as part of an adjustment to an item that is not a partnership-related item, including in a partner examination. In proposed §301.6241-7(b), only adjustments to items that are not partnership-related items are made. Nothing on the partnership's return is changed when an adjustment in a partner examination to an item that is not a partnership-related item is made under proposed §301.6241-7(b) even if the IRS adjusts the item that is not a partnership-related item as if items on the partnership's return were incorrect. Proposed §301.6241-7(b) applies only to situations where the IRS is adjusting in a partner examination an item that is not a partnership-related item and needs to determine a partnership-related item to effectuate the overall adjustment to the item that is not a partnership-related item. No other example in the regulations implementing the centralized partnership audit regime states whether each fact is determinative of the outcome, and it would cause more confusion to note determinative facts only in this one example. Therefore, the comment is not adopted. However, the term "adjusted" in proposed §301.6241-7(b) has been removed to alleviate any confusion.

Finally, as mentioned previously, one comment recommended that the effective date of §301.6241-7(b) should be the same as the other special enforcement matters in the November 2020 NPRM and not be applicable to tax years beginning after December 20, 2018, the date the rule was previewed in Notice 2019-06. The comment noted that the period of limitations on making adjustments to partnerships subject to the centralized partnership audit regime has not yet expired for taxable years beginning after December 20, 2018, and, therefore, "retroactivity" is unnecessary. As mentioned earlier, this rule was previewed in Notice 2019-06 and no comments were received.

Notice 2019-06 stated that the Treasury Department and the IRS intended that the rule, when proposed, would be applied with respect to taxable years ending after December 20, 2018. Section 301.6241-7(b) is substantially similar to the rule contained in Notice 2019-06. Therefore, this recommendation is not adopted. In addition, whether the period of limitations on making adjustments to partnerships subject to the centralized partnership audit regime has not yet expired for taxable years beginning after December 20, 2018, is not relevant to the application of this rule. Under §301.6241-7(b), the IRS may determine that the centralized partnership audit regime does not apply to any determinations regarding partnership-related items in situations described in §301.6241-7(b). Accordingly, as the IRS would be determining that the centralized partnership audit regime does not apply, it would be the partner's period of limitations on assessment that would apply and not the partnership's period of limitations on making adjustments.

B. Special relationships and extensions of the partner's period of limitations

Three comments were received on proposed §301.6241-7(f). Proposed §301.6241-7(f) permits the IRS to determine that the centralized partnership audit regime does not apply to adjustments to partnership-related items in situations where the period of limitations on making adjustments at the partnership level has expired but a partner's period of limitations on assessment has not expired and that partner has a relationship with the partnership that is described in section 267(b) or 707(b). The proposed rule also applies if the partner has expressly agreed, in writing, to extend the time to adjust and assess any tax attributable to partnership-related items for the taxable year.

The comments recommended removing proposed §301.6241-7(f) in its entirety. One of the comments expressed concern about adjusting one partner without considering how those adjustments would affect the other partners in the partnership

and noted that the rule unreasonably overlaps with proposed §301.6241-7(b) as it would also apply to managers and general partners who provide information to a partnership. However, as noted in section 4.A of the preamble (discussing partnership-related items that are components of adjustments to items that are not partnership-related items), under §301.6241-7(h)(2), an adjustment to a partnership-related item that occurs in a partner-level proceeding is not binding on the partnership or the other partners in the partnership unless they are also parties to the proceeding and §301.6241-7(b) does not apply to situations involving the partnership's own records. Accordingly, any adjustments made under proposed §301.6241-7(f) would not bind the partnership or the other partners.

That comment also expressed concern that proposed §301.6241-7(f) does not define control as it does not state under what conditions a partner could be considered to have control because sections 267(b) and 707(b) do not use concepts of control through voting or management rights. The comment concludes that control must be better defined to be administrable for the IRS and predictable to taxpayers. Finally, the comment noted that the concept of control is only referenced in proposed §301.6241-7(f)(1). Therefore, the comment concludes, proposed §301.6241-7(f) could be used to adjust any partnership-related item of any direct or indirect partner that has an open period of limitations or who agrees to extend their period of limitations.

Proposed §301.6241-7(f) provides that the IRS may adjust partnership-related items outside of the centralized partnership audit regime (that is, during a partner examination) if the period of limitations on making partnership adjustments has expired for the taxable year and one of two tests is met – (1) the partner meets the requirements under section 707(b) or is related to the partnership under section 267(b); or (2) the partner expressly agrees to extend the time to adjust and assess tax attributable to partnership-related items. While the comment stated that the applicability of the rule is

unclear because sections 267(b) and 707(b) do not use concepts of control through voting or management rights, the comment does not explain why voting or management rights should be the applicable test. However, because of the confusion expressed by this comment, the non-operative text of the heading of §301.6241-7(f)(1) has been changed from “controlled partnerships” to “special relationships” to clarify that the provision is not about actual control of the partnership but instead is solely focused on whether the partner is related to the partnership under the generally applicable rules of section 267(b) or 707(b). Under proposed §301.6241-7(f)(1), a partner is covered by the rule if the partner bears a relationship to the partnership described under section 267(b) or 707(b) without regard to whether the partner has control based on voting or management rights. This provision has been slightly reworded for clarity in the final regulations, but the rule has not changed. In addition, it is unclear how §301.6241-7(f)(1) could be used to adjust any partnership-related item for any direct or indirect partner. As stated previously, for the rule to apply the partner must either be related to the partnership under section 267(b) or 707(b) or have expressly agreed to extend the time to adjust and assess tax attributable to partnership-related items. Accordingly, if a partner is not related to the partnership as described in section 267(b) or 707(b), the only way §301.6241-7(f) will apply to the partner is if the partner expressly agrees in writing to the extension.

Two comments state that proposed §301.6241-7(f) appears to be inconsistent with Congress’s clear directive in the centralized partnership audit regime to adjust partnership-related items and to determine the period of limitations for partnership adjustments exclusively at the partnership level and that the IRS should not extend the period of limitations beyond what Congress has prescribed in section 6235. However, as discussed more fully in the introduction to section 4 of this preamble, Congress expressly provided that the Secretary could prescribe rules under which the centralized

partnership audit regime (or any portion of it) would not apply to partnership-related items. If the centralized partnership audit regime does not apply to a partnership-related item, then the item or amount is not adjusted or determined at the partnership level and the period of limitations on making adjustments at the partnership level does not apply to that adjustment or determination. Accordingly, Congress expressly provided a means to make adjustments to or determinations regarding partnership-related items and determine periods of limitations at the partner level, and, therefore, §301.6241-7(f) is consistent with congressional intent.

Two comments also expressly stated that the rationale for proposed §301.6241-7(f) contained in the preamble to the November 2020 NPRM is not that strong and does not warrant determining or extending the period of limitations by regulation as the rule applies to all partners, not merely those in tiered structures and is inconsistent with congressional intent. As stated previously, the special enforcement rules contained in §301.6241-7 are consistent with congressional intent as they implement the express rules provided by Congress in section 6241(11) of the Code. While it is correct that §301.6241-7(f) may apply outside of tiered structures and that the situation contemplated in the preamble to the November 2020 NPRM is more likely to apply in tiered structures as they may be more complex, the special enforcement considerations provided in the preamble to the November 2020 NPRM may also apply in non-tiered structures. In addition, §301.6241-7(f) does not extend the period of limitations. Section 301.6241-7(f) only applies if the partner's period of limitations has not expired and nothing in §301.6241-7(f) extends the partner's period of limitations. Although the period of limitations on making adjustments at the partnership level under section 6235 will have expired, as noted previously, if the centralized partnership audit regime does not apply to an item or amount, then the partner's period of limitations on making assessments applies to that item or amount and not the period of limitations on making

adjustments under section 6235. Accordingly, §301.6241-7(f), if applicable, merely changes what period of limitations applies but does not extend any period of limitations.

For these reasons, the recommendation to remove §301.6241-7(f) in its entirety is not adopted.

C. Chapter 1 taxes and penalties

Two comments were received on proposed §301.6241-7(g), which allows the IRS to adjust partnership-related items that are taxes, penalties, additions to tax, or additional amounts (including making any determinations necessary to make those adjustments) imposed on the partnership under chapter 1 outside of the centralized partnership audit regime. One comment recommended that §301.6241-7(g) be withdrawn because the rule is not necessary within the construct of the centralized partnership audit regime as the commenter does not believe a partnership-partner would owe an imputed underpayment as a result of the audited partnership electing to push out the adjustments. The comment noted that there should not be a second proceeding to make adjustments at the partner level. This comment seems to misunderstand the application of proposed §301.6241-7(g). The comment seems to be based on language in the preamble of the November 2020 NPRM that was discussing proposed changes to §301.6225-1 and not proposed §301.6241-7(g). As proposed §301.6241-7(g) does not apply in any of the situations the comment expresses concern about, the comment is not adopted. A comment noted that items under chapter 1 are imposed on partners, not partnerships, and that §301.6241-6 already addresses taxes outside of chapter 1. That comment recommended that proposed §301.6241-7(g) be amended to clarify its scope and purpose, and both comments requested that examples be added. This recommendation has been adopted.

Under chapter 1 of the Code, a partnership may, in certain circumstances, be directly liable for taxes, penalties, additions to tax, or additional amounts. In these

circumstances, the amount is assessed and collected from the partnership and not its partners. For example, a real estate mortgage investment conduit may have a liability under §§860F or 860G. As another example, a partnership that has self-certified as a qualified opportunity fund under §1400Z-2(d)(1) may have a liability under §1400Z-2. Although chapter 1 liability for partnerships is rare, it does exist and more circumstances could be added by Congress in the future. These amounts are the ones covered by §301.6241-7(g). Section 301.6241-7(g) does not apply to any taxes outside of chapter 1, and it does not apply to any taxes, penalties, additions to tax, or additional amounts which, under the Code, would be assessed and collected from the partners of the partnership. Because §301.6241-7(g) does not apply to taxes outside of chapter 1, it does not apply to any adjustments to an imputed underpayment as an imputed underpayment is a tax imposed by subchapter C of chapter 63 and not chapter 1. Although under section 6232(a) an imputed underpayment is assessed and collected as if it were a tax imposed by subtitle A (which includes chapter 1), an imputed underpayment is determined under the provisions of subchapter C of chapter 63, and the partnership's liability for any imputed underpayment is created under subchapter C of chapter 63. This includes any imputed underpayment of the audited partnership as well as any imputed underpayment a pass-through partner is liable for under section 6226(b)(4)(A)(ii)(II) when the pass-through partner fails to furnish statements to its partners when the pass-through partner receives a push out statement from another pass-through entity. Proposed §301.6241-7(g) does not create a second partner-level proceeding to make adjustments as proposed §301.6241-7(g) only applies to any chapter 1 taxes and penalties that are the liability of the audited partnership and, therefore, does not apply to any partners.

Also, an example is added to §301.6225-1(h)(15) to illustrate how adjustments to partnership-related items that are taxes, penalties, additions to tax, or additional amounts under chapter 1 are made under these regulations.

Another comment recommended creating a new grouping for adjustments to chapter 1 taxes and penalties that are the liability of the partnership and adjustments to an imputed underpayment calculated by the partnership. The comment noted that the new grouping would act just like the credit grouping, however, the comment recommended not using the existing credit grouping as this may cause confusion because these items are not credits. Although the Treasury Department and the IRS agree that chapter 1 liabilities of the partnership and the imputed underpayment are not credits, adding an additional grouping would create an administrative burden on the IRS as it would require amending all forms, instructions, worksheets, computer programs, and internal processes that involve groupings. The administrative burden that would be imposed on the IRS far outweighs any confusion that may occur in the rare situation where the imputed underpayment or chapter 1 taxes or penalties are adjusted and placed into the credit grouping. In addition, although these items are not technically credits, the items easily operate like credits for purposes of the calculation of the imputed underpayment, and thus it is logical to include them with the credit grouping and treat them similarly. Accordingly, this comment is not adopted.

D. Adjustments to imputed underpayments

One comment was received on the provisions for situations where the IRS makes an adjustment to an imputed underpayment calculated by the partnership (for example, as part of the filing of an AAR). These provisions were proposed amendments to §301.6225-1(c)(3), (e)(3)(ii), (f)(1)(ii), (f)(3), and §301.6226-2(g)(4).

The comment stated that proposed §301.6226-2(g)(4) limits the partnership's ability to push out an imputed underpayment that arises from the adjustment to a

previously calculated imputed underpayment and stated that nothing in the Code or legislative history implies that there is a limitation on the push out election. The comment recommended that a partnership that has filed an AAR be permitted to push out any adjustments made to the imputed underpayment included on the AAR. As previously noted, there is no legislative history of the centralized partnership audit regime, but the Treasury Department and the IRS agree that section 6226 does not limit the ability of a partnership to elect to push out to each partner from the reviewed year that partner's share of any adjustment to a partnership-related item.

Under section 6241(2)(B)(i), the imputed underpayment is included within the definition of "partnership-related item." Accordingly, any adjustment to an imputed underpayment must be made under the centralized partnership audit regime. The comment stated that any adjustment to an imputed underpayment should not result in a second imputed underpayment. The comment stated that the IRS could merely adjust the incorrect imputed underpayment, assess the difference against the partnership, and issue notice and demand to the partnership. The comment did not provide the source of the authority for the IRS to assess a change in an imputed underpayment without making an adjustment to the imputed underpayment under the centralized partnership audit regime.

Under section 6221, any adjustment to a partnership-related item, including an imputed underpayment, must be determined at the partnership level under subchapter C of chapter 63. Under section 6232(b), the IRS may not assess an imputed underpayment if the IRS does not issue an FPA to the partnership it is assessing. As the comment correctly noted, there are several instances in which a partnership (or other pass-through partner) can be liable for an imputed underpayment that is calculated by the partnership -- when the partnership files an AAR and does not elect to push out the adjustments to its reviewed year partners, when a pass-through

partner pays an imputed underpayment as part of an amended return modification, and where a pass-through partner fails to timely issue statements to its partners when it receives a statement under section 6226 and is, therefore, liable for an imputed underpayment. In all of these circumstances, the partnership has chosen to be liable for an imputed underpayment and has not chosen to pass the adjustments out to its partners. In all of these circumstances, the IRS has not issued an FPA to the partnerships at issue. Because these examples are not examples in which the partnership is self-reporting the amount of the imputed underpayment and no FPA has been issued, section 6232(b) prohibits the IRS from assessing an imputed underpayment calculated on an adjustment the IRS makes to a partnership-related item (in this case, an imputed underpayment).

As previously mentioned, in all cases where the IRS is making an adjustment to an imputed underpayment previously calculated by a partnership, the partnership is liable for the imputed underpayment, and the time to forego that liability by pushing out the adjustments to its partners has passed. In cases where the adjustment is solely to the previously calculated imputed underpayment, §301.6226-2(g)(4) provides that the partnership cannot push out the imputed underpayment to its partners from the reviewed year. Although section 6226 does not contain a limitation on the ability to elect to push out the adjustments, there are key differences here.

First, the partnership has already chosen to be liable for the imputed underpayment that has been adjusted. The imputed underpayment is only ever the liability of the partnership and not the partners because the deadline to push out the adjustments that resulted in the imputed underpayment has passed. Therefore, if the partnership could make a push out election of this portion of the imputed underpayment that adjustment would be allocable to the partnership. See generally §301.6226-2(f)(1)(ii) and (iii) (unless adjusted, a partner's share of the adjustments is the same as it

was allocated originally or how they would be allocated if the item was included on the partnership return). An imputed underpayment is not an item that is allocable to partners on a Schedule K-1; rather it is an entity-level liability of the partnership. Accordingly, there would be no practical difference between pushing out the imputed underpayment adjustment to itself and paying the imputed underpayment at the time it pushes out any unrelated adjustments to its partners. Practically, in both situations the partnership would be liable for the change in the imputed underpayment in the adjustment year.

Second, allowing the partnership to push out an adjustment to an imputed underpayment to its partners would frustrate the intent of the centralized partnership audit regime by allowing a partnership to circumvent sections 6225 and 6226 in situations where these provisions have already determined that the partnership is liable for the underlying imputed underpayment that is being adjusted. There is nothing under sections 6226 or 6227 that allows a partnership to push out the adjustments that resulted in an imputed underpayment to its reviewed year partners after the deadline for making that election or furnishing the statements has passed. Once the deadline has passed, the partnership is liable for the imputed underpayment.

Finally, allowing the partnership to push out portions of an imputed underpayment to its partners for them to pay might prevent the assessment and collection of the imputed underpayment, which would frustrate the purpose of the centralized partnership audit regime. Under section 6226(b), a partner takes the pushed-out adjustments into account by calculating the amount by which the partner's chapter 1 tax would have changed in the first affected year and any intervening year. This change in chapter 1 tax is referred to in §301.6226-3 as the additional reporting year tax, and it is a tax for the year in which the statement was furnished by the audited partnership and not the prior years. However, an imputed underpayment is not a tax

under chapter 1. An imputed underpayment is imposed by subchapter C of chapter 63. Therefore, if a partnership was allowed to push out portions of the imputed underpayment to be paid by its partners, section 6226(b) would arguably exclude that imputed underpayment portion from the calculation of the additional reporting year tax. No other provision in the Code would allow the IRS to assess an imputed underpayment on a partner in situations where the partnership has made an election under section 6226, leaving the IRS without a method to assess. Therefore, the recommendation to allow a partnership to push out an adjustment to an imputed underpayment is not adopted.

E. Indirect methods of proof of income

One comment was received on proposed §301.6241-7(e), which implements section 6241(11)(B)(iv). Under proposed §301.6241-7(e) the IRS may adjust any partnership-related item as part of a determination of a partner's liability if that determination is based on an indirect method of proof of income. The comment recommended that §301.6241-7(e) be revised to include a definition of "indirect method of proof of income" so that taxpayers understand precisely when the rule could apply given the extraordinary power of the special enforcement rules. The comment also recommended that the definition be proposed in a notice of proposed rulemaking so it will be open to notice and comment.

Under TEFRA, section 6231(c) provided that, for special enforcement matters, the IRS may, through regulations, treat partnership items that interfere with the effective and efficient enforcement of subchapter C of chapter 63 as nonpartnership items. One of those special enforcement matters is indirect methods of proof of income. Section 6231(c)(1)(C). Section 301.6231(c)-6 provides rules for the determination of a partner's liability that is based on an indirect method of proof of income. Both §301.6241-7(e) and §301.6231(c)-6 use the phrase "indirect methods of proof of income." Additionally,

both section 6241(11)(B)(iv) and section 6231(c)(1)(C) use the phrase “indirect methods of proof of income.” The term “indirect methods of proof of income” is not a term of art under either TEFRA or the centralized partnership audit regime. The meaning of the term in TEFRA and the centralized partnership audit regime is the same as the term is used in other areas of tax law. Indirect methods of proof of income are well-established methods under case law for situations where a taxpayer’s income is determined using indirect evidence. Having different definitions of “indirect methods of proof of income” for partnership proceedings would result in confusion to both the IRS and taxpayers. For the reasons stated, the comment is not adopted.

F. General comments

One comment recommended changes to the phrasing of the special enforcement provisions. The comment recommended that the regulations under §301.6241-7 be modified to be more like the regulations implementing section 6231(c) under TEFRA which, as previously mentioned, is also about special enforcement matters. The regulations that implement section 6231(c) are §§301.6231(c)-3 through 301.6241(c)-8 (TEFRA special enforcement regulations). The comment also made recommendations about the terms used in proposed §301.6241-7.

i. Discretion of the IRS in Utilizing the Special Enforcement Rules

All of the provisions under proposed §301.6241-7 provide that the IRS may make adjustments or determinations about partnership-related items outside of the centralized partnership audit regime. The IRS has discretion regarding whether to utilize these rules if the conditions prescribed for each special enforcement matter are met. Under TEFRA, there are five special enforcement matters contained in the TEFRA special enforcement regulations – termination and jeopardy assessments; criminal investigations; indirect methods of proof of income; bankruptcy and receivership; and prompt assessment. For all of these special enforcement considerations, if the

specified event occurs, the TEFRA special enforcement provision automatically applies, and the partnership items of the partner to whom the special enforcement matter applies become nonpartnership items.

The comment stated that, under the TEFRA special enforcement regulations, the IRS has no discretion not to apply the special enforcement rules if the “triggering event” occurs. The comment contrasts the TEFRA rule with proposed §301.6241-7, which provides the IRS may utilize the special enforcement rules if the triggering events occur. The comment recommended that §301.6241-7(c) (termination or jeopardy assessments), (d) (criminal investigations), and (e) (indirect methods of proof of income) be modified to provide, if the triggering event occurs, that the IRS has no discretion to apply the special enforcement rules due to the extraordinary consequences of special enforcement.

The comment is correct that under the TEFRA special enforcement regulations if the specified triggering event occurs the special enforcement rules automatically apply. However, the automatic triggering of the rules does not mean that the IRS lacks discretion regarding whether the special enforcement rules apply. Except for the rules on bankruptcy and receivership and prompt assessment, each special enforcement rule in TEFRA is triggered by an affirmative exercise of discretion by the IRS. For example, under §301.6231(c)-5, which provides rules for criminal investigations, for this provision to apply, the partner must be under criminal investigation and the IRS must also send the partner a letter expressly telling the partner that his or her partnership items will be treated as nonpartnership items. The IRS has discretion whether to send such a letter. Similarly, the IRS has discretion regarding whether to take the affirmative action that would trigger the application of the TEFRA special enforcement regulations such as deciding whether to make a termination or jeopardy assessment or issue a statutory

notice of deficiency based on an indirect method of proof. §§301.6231(c)-4; 301.6231(c)-6.

Under the TEFRA special enforcement regulations, only two rules have a triggering event that is not an action of the IRS. Under §301.6231(c)-7, generally, the partnership items of a partner are treated as nonpartnership items if the partner has filed for bankruptcy or is in a receivership proceeding. Section 301.6241(c)-7 does not require the IRS to be notified or know about the bankruptcy or receivership. In many situations the IRS does not learn that a specific partner has been in bankruptcy or receivership until well into the TEFRA proceeding at a time when the partner's period of limitations on assessment would have expired if it was not for the minimum period described in section 6229. This has caused substantial administrative problems for the IRS because the IRS may be properly obtaining extensions under section 6229(b) but those would be inapplicable to a specific partner based on facts not known to the IRS.

In addition, there are fundamental differences between TEFRA and the centralized partnership audit regime that affect whether the special enforcement rules should automatically apply if the triggering event occurs. Under TEFRA, any adjustments made during a TEFRA proceeding are ultimately passed to the partners who are liable for any taxes on those adjustments. In contrast, in the centralized partnership audit regime the proceeding is one of the partnership and not the partners, and the examination is determining the liability of the partnership and not the partners. Therefore, there may be situations where utilizing the special enforcement rules under §301.6241-7 are not appropriate, even if the provision would apply because there is a liability being determined in a proceeding under the centralized partnership audit regime. For example, the IRS may already have the partnership under examination or the partnership may have already filed a petition in response to an FPA. In those cases, it may be more efficient to include those adjustments with the other adjustments

being made rather than make adjustments in two parallel proceedings, especially if the partnership proceeding is close to resolution. Therefore, for the reasons discussed previously, the comment is not adopted.

The comment also noted that, unlike TEFRA, §301.6241-7 does not address a situation where a partner and the partnership have different taxable years, although the comment noted that one of the TEFRA special enforcement provisions also does not address this situation. The comment recommended that the proposed rules in §301.6241-7 be revised to adopt the language from the TEFRA special enforcement regulations to provide that the special enforcement rules under §301.6241-7 apply to partnership-related items arising in any partnership taxable year ending on or before the last day of the taxable year of the partner.

Although the TEFRA special enforcement regulations (except one), provide specific rules regarding which taxable year or years the provision applies to, as the comment correctly noted, the TEFRA special enforcement regulations automatically apply if the specified triggering event occurs. In addition, the TEFRA special enforcement regulations apply to all partnership items of a partner, not specified ones as in §301.6241-7, so it is clear which items are treated as nonpartnership items and for which years without any notification from the IRS. As discussed previously, the rules under proposed §301.6241-7 do not automatically apply if the specific triggering event occurs, and the partner will not have to determine whether the rule applies and to which items or years. Under §301.6241-7(h), the IRS will notify, in writing, the taxpayer who is being adjusted that the rule will apply. As the partner will have specific information directly from the IRS as to his or her specific facts and circumstances, the comment is not adopted.

ii. Items and Adjustments

One comment was received regarding the use of the term “adjustment” in proposed §301.6241-7. Under 6241(11), the Treasury Department and the IRS may prescribe regulations for special enforcement matters under which the centralized partnership audit regime (or any portion thereof) does not apply to such items. Under proposed §301.6241-7, which implements section 6241(11), the IRS may adjust partnership-related items outside of the centralized partnership audit regime in the specified special enforcement matters.

The comment recommended that proposed §301.6241-7 be revised to state that a partnership-related item (and any related penalties) that the IRS determines is not subject to the centralized partnership audit regime is subject to deficiency procedures under subchapter B of chapter 63. The comment stated that the use of the term “adjustments” is inconsistent with the authority under section 6241(11), which expressly provides that section 6241(11) applies to partnership-related “items.”

As an initial matter, it is unclear from the comment whether the comment has interpreted proposed §301.6241-7 to apply to an entire partnership-related item, or just a partner’s portion of a partnership-related item such that if the IRS utilizes the special enforcement rules the entire partnership-related item may not be adjusted under the centralized partnership audit regime. If the IRS utilized the special enforcement rules, only the portion of the partnership-related item(s) to which the special enforcement provision applies may be adjusted or determined outside of the centralized partnership audit regime.

In addition, utilizing the special enforcement rules to adjust partnership-related items as part of an adjustment being made at the partner level where a special enforcement matter exists does not prohibit the IRS from adjusting the entire partnership-related item under the centralized partnership audit regime. The partnership is not bound by any determinations in a partner-level proceeding to which it

is not a party. Proposed §301.6241-7(i) contains rules for coordinating adjustments made to partnership-related items at the partnership level so that the same partnership-related item is not taxed twice. In addition, a partnership may request to modify the imputed underpayment based on adjustments previously taken into account by a partner.

The special enforcement rules only apply if there is a special enforcement matter. In a partnership not all partners have the same facts and circumstances. Therefore, there may be a special enforcement matter for one partner but not another. The IRS may not adjust partnership-related items outside of the centralized partnership audit regime that would be allocable to a partner who does not have a special enforcement matter. This rule is similar to the rule under TEFRA. Under section 6231(c)(2) partnership items are treated as nonpartnership items if a special enforcement matter exists, to the extent provided in regulations. Under the TEFRA special enforcement regulations, only the partnership items of the specific partner who has the special enforcement matter are treated as nonpartnership items. In order to alleviate any confusion, in response to this comment, §301.6241-7(a) is modified to clarify that only the portion of the partnership-related item that is subject to the special enforcement rules may be adjusted outside of the centralized partnership audit regime and that §301.6241-7 does not prohibit the IRS from adjusting the entire partnership-related item under the centralized partnership audit regime.

With regard to the use of the term “adjustments” instead of “items,” section 6241(11) applies to partnership-related items. The term “partnership-related item” is a term of art under the centralized partnership audit regime and is defined in section 6241(2)(B). As a term of art, “partnership-related” is not separate from “item.” Under the centralized partnership audit regime, adjustments are made to partnership-related items. The rules under §301.6241-7 apply to partnership-related items and provide

rules for adjusting those partnership-related items in situations where there is a special enforcement matter. Accordingly, the special enforcement rules already apply to “items.” In addition, the Treasury Department and the IRS are unaware of any situation where no adjustment is being made to an item and yet the application of the centralized partnership audit regime would matter. For the reasons stated, this comment is not adopted.

In addition, if an adjustment is made outside of the centralized partnership audit regime, that adjustment would be subject to the rules that would apply if the centralized partnership audit regime did not exist. Accordingly, deficiency procedures would apply to the adjustment if the adjustment would be subject to deficiency procedures for a taxpayer not subject to the centralized partnership audit regime. To the extent the comment is recommending extending deficiency procedures to adjustments that would not normally be subject to deficiency procedures, the comment is not adopted. The comment provides no rationale for why an adjustment made outside of the centralized partnership audit regime using the special enforcement rules should be different than an adjustment that is made to an item that is not subject to the centralized partnership audit regime.

5. Comments Outside the Scope of the November 2020 NPRM

One comment included several recommendations that are outside the scope of the November 2020 NPRM. Accordingly, no response is provided for those recommendations, which include a recommendation to amend §301.6225-1(e)(3)(ii) to provide that net negative adjustments to credits can always be used to reduce the imputed underpayment. Although the November 2020 NPRM proposed adding a sentence to §301.6225-1(e)(3)(ii), the proposed change was limited to adding a sentence about net negative adjustments to taxes and penalties for which the partnership is liable for under chapter 1; it did not repropose the entire paragraph. The

recommendation in the comment would require modifying the portion of §301.6225-1(e)(3)(ii) that was not proposed to be amended in the November 2020 NPRM. The addition to §301.6225-1(e)(3)(ii) in the November 2020 NPRM is unrelated to the provision about netting credits contained in other portions of §301.6225-1(e)(3)(ii). Therefore, this comment is outside the scope of the November 2020 NPRM.

The comment also included some recommendations on modifications to forms and instructions. The November 2020 NPRM does not propose any rules regarding forms and instructions. Accordingly, this comment is outside of the scope of the November 2020 NPRM.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

In accordance with the Regulatory Flexibility Act (5 U.S.C. 601 et seq.) it is hereby certified that this final rule will not have a significant economic impact on a substantial number of small entities.

The final rules directly affect any partnership subject to the centralized partnership audit regime under subchapter C of chapter 63. As all partnerships are subject to the centralized partnership audit regime unless they make a valid election out of the regime, the final rules are expected to affect a substantial number of small entities. However, the IRS has determined that the economic impact on small entities affected by the final rule would not be significant.

The final rules under §301.6241-7 implement section 6241(11) and allow the IRS, for partnership-related items that involve special enforcement matters, to provide that the centralized partnership audit regime (or a portion thereof) does not apply to

such partnership-related items and that such items are subject to special rules as is necessary for the efficient and effective enforcement of the Code. As such, the rules provide for certain situations where partnership-related items may be adjusted outside of the centralized partnership audit regime. In all but one of these situations (involving chapter 1 taxes and penalties that are the liability of the partnership), if the rules in §301.6241-7 were utilized, then the adjustments would be made to partners of the partnership, rather than the partnership itself and, thus, utilizing the final rules would not have an impact on small entities. Additionally, many small entities may be eligible to elect out of the centralized partnership audit regime under section 6221(b). Accordingly, if a small entity is eligible to elect out, they may choose to elect out of the regime at which point the rules contained in §301.6241-7 would be inapplicable to those entities.

Finally, the final rules under §301.6241-7 address the process for conducting an examination and do not have a significant economic impact on small entities as the rules do not affect entities' substantive tax, such as the requirement to include items in income or the deductibility of items. The final rules promulgated under other Code sections simply clarify sections of regulations previously published.

The Secretary hereby certifies that the final rule will not have a significant economic impact on a substantial number of small entities.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Statement of Availability of IRS Documents

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin)

and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at www.irs.gov.

Drafting Information

The principal author of these regulations is Jennifer M. Black of the Associate Chief Counsel (Procedure and Administration). However, other personnel from the Treasury Department and the IRS participated in the development of the regulations.

List of Subjects in 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding entries in numerical order for §§301.6221(b)-1 and 301.6241-7 to read in part as follows:

Authority: 26 U.S.C. 7805.

* * * * *

Section 301.6221(b)-1 also issued under sections 6221 and 6241.

* * * * *

Section 301.6241-7 also issued under section 6241.

* * * * *

Par. 2. Section 301.6221(b)-1 is amended by revising paragraphs (b)(3)(ii)(D) and (F), adding paragraph (b)(3)(ii)(G), and adding a sentence to the end of paragraph (f) to read as follows:

§301.6221(b)-1 Election out for certain partnerships with 100 or fewer partners.

* * * * *

(b) * * *

(3) * * *

(ii) * * *

(D) A wholly owned entity disregarded as separate from its owner for Federal income tax purposes,

* * * * *

(F) Any person who holds an interest in the partnership on behalf of another person, or

(G) A qualified subchapter S subsidiary, as defined in section 1361(b)(3)(B).

* * * * *

(f) * * * Notwithstanding the preceding sentence, paragraphs (b)(3)(ii)(D), (F), and (G) of this section apply to taxable years ending on or after November 20, 2020.

§301.6223-1 [Amended]

Par. 3. Section 301.6223-1 is amended in paragraph (e)(8) by

a. Removing the language “B” and “B’s” and adding “PR” and “PR’s” in their place, respectively, in Example 1; and

b. Removing “B’s” and adding “PR’s” in its place in Example 2.

Par. 4. Section 301.6225-1 is amended:

a. By revising the paragraph (b)(3) subject heading;

b. By adding two sentences to the end of paragraph (b)(4);

c. By adding a sentence to the end of paragraph (c)(3);

d. By revising paragraphs (d)(2)(ii) and (iii);

e. By removing reserved paragraph (d)(3)(iii)(C);

f. By adding a sentence to the end of paragraph (e)(3)(ii);

g. By revising paragraph (f)(1)(ii);

h. By adding paragraph (f)(3);

i. By adding paragraphs (h)(13), (14), and (15); and

j. By adding a sentence to the end of paragraph (i)(1).

The revisions and additions read as follows:

§301.6225-1 Partnership adjustment by the Internal Revenue Service.

* * * * *

(b) * * *

(3) Adjustments to items for which tax has been collected under chapters 3 and 4 of the Internal Revenue Code (Code). * * *

(4) * * * In addition, if a positive adjustment to an item is related to, or results from, a positive adjustment to another item, one of the positive adjustments will generally be treated as zero solely for purposes of calculating any imputed underpayment unless the IRS determines that an adjustment should not be treated as zero in the calculation of the imputed underpayment. This paragraph applies to the calculation of any imputed underpayment, including imputed underpayments calculated by a partnership or pass-through partner (for example, as part of the filing of an administrative adjustment request (AAR) under section 6227).

(c) * * *

(3) * * * Each adjustment to any tax, penalty, addition to tax, or additional amount for the taxable year for which the partnership is liable under chapter 1 of the Code (chapter 1) and each adjustment to an imputed underpayment calculated by the partnership is placed in the credit grouping.

* * * * *

(d) * * *

(2) * * *

(ii) Negative adjustment. A negative adjustment is any adjustment that is a decrease in an item of income; a partnership adjustment treated under paragraph (d)(2)(i) of this section as a decrease in an item of income; an increase in an item of

credit; a decrease in an item of tax, penalty, addition to tax, or additional amount for which the partnership is liable under chapter 1; or a decrease to an imputed underpayment calculated by the partnership for the taxable year.

(iii) Positive adjustment. A positive adjustment is any adjustment that is not a negative adjustment as defined in paragraph (d)(2)(ii) of this section.

* * * * *

(e) * * *

(3) * * *

(ii) * * * A net negative adjustment to a tax, penalty, addition to tax, or additional amount for which the partnership is liable under chapter 1 or an adjustment to any imputed underpayment calculated by the partnership for the taxable year is not an adjustment described in paragraph (f) of this section (adjustments that do not result in an imputed underpayment).

* * * * *

(f) * * *

(1) * * *

(ii) The calculation under paragraph (b)(1) of this section results in an amount that is zero or less than zero, unless paragraph (f)(3) of this section applies.

* * * * *

(3) Exception to treatment as an adjustment that does not result in an imputed underpayment--(i) Application of this paragraph (f)(3). If the calculation under paragraph (b)(1) of this section results in an amount that is zero or less than zero due to the inclusion of a net negative adjustment to a tax, penalty, addition to tax, or additional amount for which the partnership is liable under chapter 1 or an adjustment to any imputed underpayment calculated by the partnership for the taxable year, this

paragraph (f)(3) applies, and paragraph (f)(1) of this section does not apply except as provided in paragraph (f)(3)(ii)(C) of this section.

(ii) Recalculation if paragraph (f)(3) of this section applies--(A) In general. If this paragraph (f)(3) applies, the imputed underpayment is recalculated under paragraph (b)(1) of this section without regard to a net negative adjustment to a tax, penalty, addition to tax, or additional amount for which the partnership is liable under chapter 1 or an adjustment to any imputed underpayment calculated by the partnership for the taxable year. The net negative adjustment that was excluded from the imputed underpayment recalculation is then treated in one of two ways under paragraphs (f)(3)(ii)(B) and (C) of this section depending on the results of the recalculation.

(B) Recalculation is greater than zero. If the result of the recalculation under paragraph (f)(3)(ii) of this section is greater than zero, the IRS may apply the portion of the net negative adjustment(s) that was excluded from the recalculation to reduce the imputed underpayment to zero, but not below zero. In this case, the imputed underpayment is zero, but the adjustments included in the recalculation and the remaining net negative adjustment(s) excluded from the recalculation under paragraph (f)(3)(ii)(A) of this section are not adjustments that do not result in an imputed underpayment subject to treatment as described in paragraph (f)(2) of this section. See paragraph (h)(13) of this section (Example 13).

(C) Recalculation is zero or less than zero. If the result of the recalculation under paragraph (f)(3)(ii) of this section is zero or less than zero, the adjustments included in the recalculation are treated as adjustments that do not result in an imputed underpayment under paragraph (f)(1)(ii) of this section. The net negative adjustment(s) that was excluded from the recalculation is not an adjustment that does not result in an imputed underpayment subject to treatment as described in paragraph (f)(2) of this section. See paragraph (h)(14) of this section (Example 14).

(h) * * *

(13) Example 13. The IRS initiates an administrative proceeding with respect to Partnership's 2019 partnership return and makes adjustments as follows: net positive adjustment of \$100 ordinary income, net negative adjustment of \$20 in credits, and a net negative adjustment of \$25 to a chapter 1 tax liability of the partnership. The IRS determines that the net negative adjustment in credits should be taken into account in the calculation of the imputed underpayment in accordance with paragraph (b)(1)(v) of this section. Pursuant to paragraph (b)(1) of this section, the \$100 net positive adjustment to ordinary income is multiplied by 40 percent (highest tax rate in effect), which results in a \$40 imputed underpayment. The adjustments in the credits grouping are then applied, which include the adjustment to credits and the adjustment to the chapter 1 tax liability. Applying the credits results in an amount less than zero as described in paragraph (f)(3)(i) of this section ($\$40 - \$20 - \$25 = -\5). Pursuant to paragraph (f)(3)(ii) of this section, the imputed underpayment is recalculated without regard to the adjustment to the chapter 1 tax liability, resulting in a recalculation amount greater than zero as described in paragraph (f)(3)(ii)(B) of this section ($\$40 - \$20 = \$20$). Pursuant to paragraph (f)(3)(ii)(B) of this section, the IRS may apply a portion of the adjustment to chapter 1 tax liability to reduce the recalculation to zero but not below zero. In this case, the recalculation amount would be reduced to zero using \$20 of the \$25 adjustment to chapter 1 tax liability. Because the imputed underpayment was reduced to zero, pursuant to paragraph (f)(3)(ii)(B) of this section, the adjustments that went into the recalculation are not adjustments that do not result in an imputed underpayment. These adjustments are the \$100 adjustment to ordinary income and the \$20 adjustment to credits. The remaining \$5 adjustment to the chapter 1 tax liability of the partnership is an adjustment that is treated as described in paragraph (e)(3)(ii) of this section and is therefore not taken into account on the partnership's adjustment year return.

(14) Example 14. The facts are the same as in paragraph (h)(13) of this section (Example 13), but the negative adjustment to credits is \$50 instead of \$20. Applying the credits results in an amount less than zero as described in paragraph (f)(3)(i) of this section ($\$40 - \$50 - \$25 = -\35). Pursuant to paragraph (f)(3)(ii) of this section, the imputed underpayment is recalculated without regard to the adjustment to the chapter 1 tax liability, resulting in a recalculation amount less than zero as described in paragraph (f)(3)(ii)(C) of this section ($\$40 - \$50 = -\$10$). Pursuant to paragraph (f)(3)(ii)(C) of this section, the partnership adjustments resulting in the $-\$10$ recalculation amount are adjustments that do not result in an imputed underpayment treated in accordance with paragraph (f)(1)(ii) of this section, and the \$25 adjustment to chapter 1 tax liability is not treated as such an adjustment and is therefore not taken into account on the partnership's adjustment year return.

(15) Example 15. On its timely filed return for the 2022 taxable year, Partnership reports that it self-certified as a qualified opportunity fund, as defined in section 1400Z-2(d). Partnership also reports that it has not satisfied the 90-percent investment standard, as defined in § 1.1400Z2(a)-1(b)(4) of this chapter, and reports an amount due under section 1400Z-2(f) of \$100. The IRS does not utilize §301.6241-7(g) to determine adjustments to these partnership-related items without regard to subchapter C of chapter 63. In an administrative proceeding involving Partnership's 2022 taxable year, the IRS, in examining the amount due under section 1400Z-2(f), determines that

Partnership incorrectly reported its qualified opportunity zone property for one month and that there should be one \$40 adjustment to reduce the assets Partnership reported as qualified opportunity zone property. The IRS also determines that the basis of one of Partnership's qualified opportunity zone properties should be reduced by \$30. Under paragraph (d) of this section, the adjustments to the basis and character of an asset are not adjustments to an item of income. Therefore, the \$30 adjustment to the basis of the asset and the \$40 recharacterization of an asset are treated as positive adjustments. As a result of the determinations, the IRS determines that the amount due for Partnership failing the section 1400Z-2(d)(1) investment standard should be increased. This results in a \$4 adjustment to Partnership's liability under section 1400Z-2(f) which, under paragraph (d)(2) of this section is a positive adjustment because it is an increase in an amount Partnership is liable for under chapter 1. The total netted partnership adjustment for the 2022 taxable year is \$70 (\$30 basis adjustment + \$40 recharacterization adjustment). Under paragraph (c)(3) of this section, the \$4 adjustment to Partnership's liability under chapter 1 is treated as an adjustment to a credit. Assuming the highest rate under section 1 or 11 is 40% this results in an imputed underpayment of \$32 $(\$70 \times 40\%) + \4 section 1400Z-2(f) adjustment). The IRS issues a notice of final partnership adjustment to Partnership for its 2022 taxable year and Partnership makes a timely election under section 6226 with regard to the \$32 imputed underpayment. Under §301.6226-2(g)(1), when Partnership furnishes statements to its reviewed year partners, Partnership must pay the \$4 section 1400Z-2(f) amount because it is the liability of Partnership and may not include that adjustment in the statements.

(i) * * *

(1) * * * Notwithstanding the preceding sentence, paragraphs (b)(4), (c)(3), (d)(2)(ii), (d)(3)(iii)(C), (e)(3)(ii), (e)(3)(iii)(B), (f)(1)(ii), (f)(3), and (h)(13), (14), and (15) of this section apply to taxable years ending on or after November 20, 2020.

* * * * *

Par. 5. Section 301.6225-2 is amended:

a. In paragraph (d)(2)(vi)(A), by removing the period and the end of the paragraph and adding in its place “, by treating any approved modifications and partnership adjustments allocable to the pass-through partner as items reflected on the statement furnished to the pass-through partner.”;

b. By revising paragraph (d)(2)(vi)(B); and

c. By adding a sentence to the end of the paragraph (g)(1).

The revision and addition read as follows:

§301.6225-2 Modification of imputed underpayment.

* * * * *

(d) * * *

(2) * * *

(vi) * * *

(B) Adjustments that do not result in an imputed underpayment. If a pass-through partner takes into account its share of the adjustments by paying an amount described in paragraph (d)(2)(vi)(A) of this section and there are any adjustments that do not result in an imputed underpayment (as defined in §301.6225-1(f)), those adjustments are taken into account by the pass-through partner in accordance with §301.6225-3 in the taxable year of the pass-through partner that includes the date the payment described in paragraph (d)(2)(vi)(A) of this section is paid. This paragraph (d)(2)(vi)(B) does not apply if, after making the calculation described in paragraph (d)(2)(vi)(A) of this section, no amount exists and therefore no payment is required under paragraph (d)(2)(vi)(A).

* * * * *

(g) * * *

(1) * * * Notwithstanding the preceding sentence, paragraph (d)(2)(vi)(B) of this section applies to taxable years ending on or after November 20, 2020.

* * * * *

Par. 6. Section 301.6225-3 is amended:

- a. In paragraph (b)(1) by removing “a reduction in non-separately stated income or as an increase in non-separately stated loss” and adding in its place “part of non-separately stated income or loss”;
- b. By adding paragraphs (b)(8) and (d)(3) through (5); and
- c. By adding a sentence to the end of paragraph (e)(1).

The additions read as follows:

§301.6225-3 Treatment of partnership adjustments that do not result in an imputed underpayment.

* * * * *

(b) * * *

(8) Adjustments to items that are not items of income, gain, loss, deduction, or credit. The partnership takes into account an adjustment that does not result in an imputed underpayment that resulted from an adjustment to an item that is not an item of income, gain, loss, deduction, or credit by adjusting the item on its adjustment year return but only to the extent the item would appear on the adjustment year return without regard to the adjustment. If the item is already reflected on the partnership's adjustment year return as an item that is not an item of income, gain, loss, deduction, or credit, or in any year between the reviewed year and the adjustment year, a partnership should not create a new item in the amount of the adjustment on the partnership's adjustment year return.

* * * * *

(d) * * *

(3) Example 3. On its partnership return for the 2020 taxable year, Partnership placed Asset into service, reporting that Asset, a non-depreciable asset, had a basis of \$100. During an administrative proceeding with respect to Partnership's 2020 taxable year, the IRS determines that Asset has a basis of \$90 instead of \$100. The IRS also determines that Partnership has a negative adjustment to credits of \$4. There are no other adjustments for Partnership's 2020 taxable year. Under §301.6225-1(d)(2)(iii), the adjustment to the basis of an asset is not an adjustment that is a decrease in an item of income, a partnership adjustment treated under paragraph §301.6225-1(d)(2)(i) as a decrease in an item of income, or an increase in an item of credit. Therefore, the \$10 adjustment to the basis of Asset is treated as a \$10 positive adjustment. The IRS determines that the net negative adjustment to credits should be taken into account as part of the calculation of the imputed underpayment. The total netted partnership adjustment is \$10, which, after applying the highest rate and decreasing the product by the \$4 adjustment to credits results in an imputed underpayment of \$0. Accordingly, both adjustments are adjustments that do not result in an imputed underpayment under §301.6225-1(f). The adjustment year is 2022 and Partnership still owns Asset. Under paragraph (b)(8) of this section, Partnership takes into account the \$10 adjustment to Asset on its 2022 return by reducing its basis in Asset by \$10. The reduction in the basis of Asset does not require Partnership to recognize income or gain in situations where income or gain is not otherwise recognized.

(4) Example 4. On its partnership return for the 2020 taxable year, Partnership reports a recourse liability of \$1,000. During an administrative proceeding with respect to Partnership's 2020 taxable year, the IRS determines that the liability is a nonrecourse liability instead of a recourse liability. The IRS also determines that Partnership has a negative adjustment to credits of \$400. There are no other adjustments for Partnership's 2020 taxable year. Under §301.6225-1(d), the adjustment to the liability is not an adjustment to an item of income. Therefore, the \$1,000 change to the liability is treated as two \$1,000 positive adjustments (a \$1,000 decrease to nonrecourse liabilities and a \$1,000 increase to recourse liabilities). The IRS determines that the adjustment to nonrecourse liabilities should be treated as zero for purposes of calculating the imputed underpayment under §301.6225-1(b)(4). The IRS also determines that the net negative adjustment to credits should be taken into account as part of the calculation of the imputed underpayment. The total netted partnership adjustment is \$1,000, which, after applying the highest rate and decreasing the product by the \$400 adjustment to credits results in an imputed underpayment of \$0. Accordingly, both adjustments are adjustments that do not result in an imputed underpayment under §301.6225-1(f). Partnership pays off the entire liability in 2021. The adjustment year is 2022. Under paragraph (b)(8) of this section, the liability no longer appears on the return due to the satisfaction of the liability in the 2021 taxable year. Accordingly, no adjustment is made to Partnership's 2022 return as a result of the adjustment to the liability. If, instead of satisfying the entire \$1,000 liability in 2021, Partnership made a payment of \$500 towards the liability, on its 2022 return, Partnership would change the character of the \$500 liability on its 2022 return to be a nonrecourse liability.

(5) Example 5. The facts are the same facts as the facts in paragraph (d)(3) (Example 3) except that Partnership has two equal partners – A and B – both of whom are individuals. After Partnership receives a notice of proposed partnership adjustment containing the \$4 negative adjustment to credits and the \$10 adjustment to Asset, Partnership requests modification under §301.6225-2(d)(2) and (e) based on A filing an amended return. On her amended return, A takes into account her share of the adjustments which is a \$2 negative adjustment to credits and a \$5 adjustment to Asset. Based on A's facts and circumstances, A does not have any tax impact as a result of the adjustment to Asset so her amended return only reflects a tax impact from the additional \$2 in credits. Because A filed an amended return, the imputed underpayment is recalculated without the portion of the adjustments allocable to A. In this case, the total netted partnership adjustment is \$5, which, after applying the highest rate and decreasing the product by the \$2 adjustment to credits results in an imputed underpayment of \$0. Accordingly, both adjustments (the \$10 adjustment to Asset and the \$4 adjustment to credits) are adjustments that do not result in an imputed underpayment under paragraph (f) of this section. The adjustment year is 2022 and Partnership still owns Asset. Under paragraph (b)(8) of this section, Partnership takes into account the \$10 adjustment to Asset on its 2022 return by reducing its basis in Asset by \$10. The reduction in the basis of Asset does not require Partnership to recognize income or gain in situations where income or gain is not otherwise recognized.

(e) * * *

(1) * * * Notwithstanding the preceding sentence, paragraphs (b)(8) and (d)(3) through (d)(5) of this section apply to taxable years ending on or after November 20, 2020.

* * * * *

Par. 7. Section 301.6226-2 is amended by:

- a. Revising the paragraph (g)(3) subject heading.
- b. Adding paragraph (g)(4).
- c. Adding a sentence to the end of paragraph (h)(1).

The revision and additions read as follows:

§301.6226-2 Statements furnished to partners and filed with the IRS.

* * * * *

(g) * * *

(3) Adjustments subject to chapters 3 and 4 of the Code. * * *

(4) Liability for chapter 1 taxes and penalties. A partnership that makes an election under §301.6226-1 with respect to an imputed underpayment must pay any taxes, penalties, additions to tax, additional amounts, or the amount of any adjustments to any imputed underpayment calculated by the partnership that is determined under subchapter C of chapter 63 for which the partnership is liable under chapter 1 of the Code or subchapter C of chapter 63 at the time the partnership furnishes statements to its partners in accordance with paragraph (b) of this section. Any adjustments to such items are not included in the statements the partnership furnishes to its partners or files with the IRS under this section.

(h) * * *

(1) * * * Notwithstanding the prior sentence, paragraph (g)(4) of this section applies to taxable years ending on or after November 20, 2020.

* * * * *

Par. 8. Section 301.6241-3 is amended:

- a. By adding a sentence to the end of paragraph (a)(1);
- b. By revising paragraph (b)(1)(ii);
- c. By removing paragraph (b)(2);
- d. By redesignating paragraphs (b)(3) and (4) as paragraphs (b)(2) and (3)

respectively;

- e. By adding a sentence to the end of newly redesignated paragraph (b)(3); and
- f. By revising paragraphs (c), (e)(2)(ii), (f)(1) and (2), and (g).

The addition and revisions read as follows:

§301.6241-3 Treatment where a partnership ceases to exist.

(a) * * *

(1) * * * A determination under this section that a partnership has ceased to exist does not prohibit the partnership from requesting modification of the imputed underpayment under section 6225(c).

* * * * *

(b) * * *

(1) * * *

(ii) The partnership does not have the ability to pay, in full, any amount that may be due under the provisions of subchapter C of chapter 63 for which the partnership is or may become liable. For purposes of this section, a partnership does not have the ability to pay if the IRS determines that the partnership's account is currently not collectible based on the information the IRS has at the time of such determination.

* * * * *

(3) * * * A determination under this section that a partnership has ceased to exist is not effective if the partnership has made a valid election under §301.6226-1 in response to a notice of final partnership adjustment or has paid all amounts due by the

partnership under subchapter C of chapter 63 within 10 days of notice and demand for payment.

(c) Partnership adjustment takes effect. For purposes of this section, a partnership adjustment under subchapter C of chapter 63 takes effect when the adjustment becomes finally determined as described in §301.6226-2(b)(1); when the partnership and the IRS enter into a settlement agreement regarding the adjustment; or, for adjustments appearing on an administrative adjustment request (AAR), when the request is filed.

* * * * *

(e) * * *

(2) * * *

(ii) The partnership must furnish statements to the former partners and file the statements with the IRS no later than 60 days after the later of the date of the notification to the partnership that the IRS has determined that the partnership has ceased to exist or the date the adjustment takes effect, as described in paragraph (c) of this section.

* * * * *

(f) * * *

(1) Example 1. The IRS initiates a proceeding under subchapter C of chapter 63 with respect to the 2020 partnership taxable year of Partnership. During 2023, in accordance with section 6235(b), Partnership extends the period of limitations on adjustments under section 6235(a) until December 31, 2025. However, on July 31, 2024, Partnership terminates within the meaning of section 708(b)(1). Based on the prior termination under section 708(b)(1), the IRS determines that Partnership ceased to exist, as defined in paragraph (b) of this section, on September 16, 2024. On February 1, 2025, the IRS mails Partnership a notice of final partnership adjustment (FPA) that determines partnership adjustments that result in a single imputed underpayment. Partnership does not timely file a petition under section 6234 and does not make a valid election under section 6226. Partnership files its final return of partnership income on October 15, 2024, listing A and B, both individuals, as the partners for its final taxable year ending July 31, 2024. Accordingly, under paragraph (d) of this section, A and B are former partners. Therefore, A and B are required to take their share of the partnership adjustments determined in the FPA into account under paragraph (e) of this section.

(2) Example 2. The IRS initiates a proceeding under subchapter C of chapter 63 with respect to the 2020 partnership taxable year of P, a partnership. G, a partnership that has an election under section 6221(b) in effect for the 2020 taxable year, is a partner of P during 2020 and for every year thereafter. On February 3, 2025, the IRS mails P an FPA that determines partnership adjustments that result in a single imputed underpayment. P does not timely file a petition under section 6234 and does not make a timely election under section 6226. On March 21, 2025, the IRS determines that P has ceased to exist because P did not make an election under section 6226, P's account is currently not collectible, and the IRS does not expect P will be able to pay the imputed underpayment. G terminated under section 708(b)(1) on December 31, 2024. On March 3, 2025, the IRS determines that G ceased to exist in 2024 for purposes of this section in accordance with paragraph (b) of this section. J and K, individuals, were the only partners of G during 2024. Therefore, under paragraph (d)(1)(ii) of this section, J and K, the partners of G during G's 2024 partnership taxable year, are the former partners of G for purposes of this section. Therefore, J and K are required to take into account their share of the adjustments contained in the statement furnished by P to G in accordance with paragraph (e) of this section.

(g) Applicability date. This section applies to any determinations made with respect to taxable years ending on or after November 20, 2020.

Par. 9. Section 301.6241-7 is added to read as follows:

§301.6241-7 Treatment of special enforcement matters.

(a) Items that involve special enforcement matters. In accordance with section 6241(11)(B) of the Internal Revenue Code (Code), the partnership-related items (as defined in §301.6241-1(a)(6)(ii)) described in this section have been determined to involve special enforcement matters. If the rules in this section apply, only the portion of the partnership-related item to which the special enforcement matter applies may be adjusted without regard to subchapter C of chapter 63. Nothing in this section prohibits the Internal Revenue Service (IRS) from adjusting the entire partnership-related item under subchapter C of chapter 63. See paragraph (i) of this section for rules coordinating adjustments made under subchapter C of chapter 63 with adjustments made without regard to subchapter C of chapter 63.

(b) Partnership-related items underlying items that are not partnership-related items--(1) In general. The IRS may determine that the rules of subchapter C of

chapter 63 of the Code (subchapter C of chapter 63) do not apply to an adjustment to a partnership-related item of a partnership if—

- (i) An examination is being conducted of a person other than the partnership;
- (ii) A determination regarding a partnership-related item is made, as part of, or underlying, an adjustment to an item that is not a partnership-related item of the person described in paragraph (b)(1)(i) of this section; and
- (iii) The treatment of the partnership-related item on the return of the partnership under section 6031(a) or in the partnership's books and records is based in whole or in part on information provided by the person described in paragraph (b)(1)(i) of this section from that person's books and records.

(2) Example. The following example illustrates the provisions of paragraph (b)(1) of this section. For purposes of this example, the partnership has no liabilities, is subject to subchapter C of chapter 63, and the partnership and partner each has a calendar taxable year. On June 1, 2018, A acquires an interest in Partnership by contributing Asset to Partnership in a section 721 contribution (Contribution). Under section 722, A claims a basis in its interest in Partnership of \$50 equal to A's purported adjusted basis in Asset at the time of the Contribution. Partnership claims a basis in Asset of \$50 under section 723 equal to A's purported adjusted basis in Asset as of June 1, 2018, based on information A provided to Partnership as part of the Contribution. There is no activity in Partnership that gives rise to any other partnership-related items between June 1, 2018, and June 2, 2019. On June 2, 2019, A sells A's interest in Partnership to B for \$100 in cash and reports a gain of \$50 based on A's purported adjusted basis in its interest in Partnership of \$50. The IRS opens an examination of A and determines that A's adjusted basis in its interest in Partnership should be \$30 instead of the \$50 claimed by A because A's Contribution to Partnership should have been \$30 instead of \$50. Under paragraph (b) of this section, the IRS may

determine that the rules of subchapter C of chapter 63 do not apply to the Contribution and make a determination about the Contribution (which is a partnership-related item under §301.6241-1(a)(6)(v)(C)) as part of an adjustment to A's adjusted basis in its interest in Partnership (which is not a partnership-related item). The IRS may make this determination because Partnership's reported basis in Asset was based on the information provided by A. Because A's adjusted basis in A's interest in Partnership is reduced to \$30, the total gain from the sale of A's interest in Partnership is increased to \$70 (\$50 as originally reported plus \$20 as adjusted by the IRS). In accordance with paragraph (h)(2) of this section, if A's basis in its interest in Partnership is adjusted based on a determination about the Contribution, Partnership and the other partners of Partnership are not bound by any determination regarding the Contribution resulting from the examination of A and no adjustment is required to be made to their returns under this section.

(c) Termination and jeopardy assessment. For any taxable year of a partner or indirect partner for which an assessment of income tax under section 6851 or section 6861 is made, the IRS may adjust any partnership-related item with respect to such partner or indirect partner as part of making an assessment of income tax under section 6851 or section 6861 without regard to subchapter C of chapter 63.

(d) Criminal investigations. For any taxable year of a partner or indirect partner for which the partner or indirect partner is under criminal investigation, the IRS may adjust any partnership-related item with respect to such partner or indirect partner without regard to subchapter C of chapter 63.

(e) Indirect methods of proof of income. The IRS may adjust any partnership-related item as part of a determination of any deficiency (or portion thereof) of the partner or indirect partner that is based on an indirect method of proof of income without regard to subchapter C of chapter 63.

(f) Special relationships and extensions of the partner's period of limitations. If the period of limitations under section 6235 on making partnership adjustments has expired for a taxable year, the IRS may adjust any partnership-related item that relates to any item or amount for which the partner's period of limitations on assessment of tax imposed by chapter 1 of the Code (chapter 1) has not expired for the taxable year of the partner or indirect partner, without regard to subchapter C of chapter 63 if—

(1) The direct or indirect partner is related to the partnership under section 267(b) or 707(b); or

(2) Under section 6501(c)(4), the direct or indirect partner agrees, in writing, to extend the partner's section 6501 period of limitations on assessment for the taxable year but only if the agreement expressly provides that the partner is extending the time to adjust and assess any tax attributable to partnership-related items for the taxable year.

(g) Penalties and taxes imposed on the partnership under chapter 1. The IRS may adjust any tax, penalties, additions to tax, or additional amounts imposed on, and which are the liability of the partnership under chapter 1 without regard to subchapter C of chapter 63. The IRS may also make determinations about any partnership-related item, without regard to subchapter C of chapter 63, as part of any adjustment made to the amount and applicability of the tax, penalty, addition to tax, or additional amount imposed on the partnership being determined without regard to subchapter C of chapter 63. Any determinations under this paragraph (g) will be treated as a determination under a chapter of the Code other than chapter 1 for purposes of §301.6241-6.

(h) Determination that subchapter C of chapter 63 does not apply--

(1) Notification. If the IRS determines, in accordance with paragraph (b), (c), (d), (e), (f), or (g) of this section, that some or all of the rules under subchapter C of chapter 63 do

not apply to any partnership-related item (or portion thereof), then the IRS will notify, in writing, the taxpayer to whom the adjustments are being made.

(2) Effect of adjustments not made under subchapter C of chapter 63. Any final decision with respect to any partnership-related item adjusted in a proceeding not under subchapter C of chapter 63 is not binding on any person that is not a party to the proceeding. For example, if the partnership or any other partner does not become a party to a partner-level proceeding conducted as a result of the application of this section, the partnership and those other partners are not bound to the adjustments determined in the partner-level proceeding.

(i) Coordination with adjustments made at the partnership level. This section will not apply to the extent the partner can demonstrate adjustments to partnership-related items included in the deficiency or an adjustment by the IRS were—

(1) Previously taken into account under subchapter C of chapter 63 by the person being examined; or

(2) Included in an imputed underpayment paid by a partnership (or pass-through partner) for any taxable year in which the partner was a reviewed year partner or indirect partner but only if the amount included in the deficiency or adjustment exceeds the amount reported by the partnership to the partner that was either reported by the partner or indirect partner or is otherwise included in the deficiency or adjustment determined by the IRS.

(j) Applicability date--(1) In general. Except for paragraph (b) of this section, this section applies to partnership taxable years ending on or after November 20, 2020. Notwithstanding the preceding sentence, upon agreement between the partner under examination and the IRS, any provision of this section except for paragraph (b) of this section may apply to any taxable year of a partner that relates to a partnership taxable year subject to subchapter C of chapter 63 (as amended) that ended before November

20, 2020. In addition, a partnership and the IRS may agree to apply paragraph (g) to any partnership taxable year ended before November 20, 2020, that is subject to subchapter C of chapter 63, as amended.

(2) Partnership-related items underlying items that are not partnership-related items. Paragraph (b) of this section applies to partnership taxable years beginning after December 20, 2018. Notwithstanding the preceding sentence, upon agreement between the partner under examination and the IRS, paragraph (b) of this section may apply to any taxable year of a partner that relates to a partnership taxable year subject to subchapter C of chapter 63, as amended, that ended on or before December 20, 2018.

Melanie R. Krause,
Acting Deputy Commissioner for Services and Enforcement.

Approved: November 15, 2022.

Lily Batchelder,
Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2022-26783 Filed: 12/8/2022 8:45 am; Publication Date: 12/9/2022]